

Federalism and Corporation Law: Drawing the Line in State Takeover Regulation

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I. INTRODUCTION

In the area of corporate control transactions, that debatable territory between securities regulation and corporation law, no issue is more difficult than defining the border between state and federal jurisdiction. The issue is posed most sharply in the context of tender offers—transactions which involve stock purchases in national securities markets, but which, as corporate takeovers, are the functional equivalents of mergers or consolidations. Here the impulse to federalize must be balanced against the continuing vitality of state law.

The principle that a corporation is a creature of the state is a rule which deserves reexamination. The doctrine is fundamental to the law of business organizations. It is a cornerstone whose role is so crucial and obvious that critical attention passes quickly over it. Having grown accustomed to the corporation, we often take it for granted. The role of the state is crucial, however, because a corporation exists only as a function of sovereignty. Just as a contract is a promise which the law will enforce, and a property right is an interest which the law will protect, a corporation is an enterprise which the law distinguishes from its human participants.

This homely legal principle assumes particular significance because the Supreme Court has relied upon it as a guiding principle of federalism. More than simply reaffirming the rule, the Court has used it to define the limits of federal concern in the corporate law area. As the Court ruled in *Cort v. Ash*,¹ and reiterated in *Santa Fe Industries, Inc. v. Green*:² “Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law *expressly* requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.”³

The Supreme Court’s reliance upon the doctrine is important in two ways. First, it offers a necessary reminder that incorporation is a privilege rather than a right. The recognition of the corporation as a legal person, and the limitation upon the liability of its members, is due to the action of the state.

This rule, moreover, confirms the traditional division of powers of regulatory authority in the area. Throughout the history of American law, the definition and supervision of business entities has been the task of the states. At the Constitutional Convention, during the Progressive Era, and at the height of the New Deal, the federal government debated whether to enter the corporate area itself and every time

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1. 422 U.S. 66 (1975).

2. 430 U.S. 462 (1977).

3. *Id.* at 479 (emphasis in original).

declined.⁴ While the intention of Congress to leave this matter to state regulation can be inferred from the persistent record of discussion pursued (a repeated pattern of discussion ending in silence), the Supreme Court's recognition of state authority has been explicit and specific.

The power of states to regulate the corporations that they charter is currently being challenged again by law-and-economists who assert that state corporate law must never be allowed to inhibit the transfer of shares in nation-wide tender offers. Their arguments admit little gradation and lay the foundation for de facto federalization of corporation law. So far, the discussion has focused on share prices in the trading market, and has been pursued without consideration of the corporation's essential nature, why the corporation exists, and by what authority shareholders acquire the rights represented by their shares.

These omissions have made the debate over takeover regulation one-sided. Furthermore, the Supreme Court's severely fragmented decision in *Edgar v. MITE Corp.*⁵ has failed to establish standards for dealing with state laws affecting tender offers. The opportunity to raise these issues and clarify the law is presented by two recent cases invalidating state control share acquisition statutes, *Dynamics Corp. of America v. CTS Corp.*⁶ and *Fleet Aerospace v. Holderman*.⁷ The chartering state's involvement with the corporation, coupled with the historical federal-state balance, illustrates the state's concern with and role in corporation law—and argues that state regulation, within these defined bounds, is constitutional.

This Article surveys the history of federal-state relationships in the corporate law area. Specifically, it deals with the relationship of the corporation to the government which charters it, relates the history of federal abstention from regulation of business associations, and outlines the important relationship of these factors to the debate over the role of the states in regulating tender offers.

II. THE CORPORATION AS A CREATURE OF THE STATE

A return to basic principles is necessary. In order to understand the corporation as a business entity, it is helpful to examine the function of incorporation which creates it. By providing for incorporation, the state allows human individuals the privilege of doing business through an entity legally distinct from themselves—an entity which exists, acts and holds property independent of them, survives them, and through which their liability is limited to the amount of their investment. These capabilities exist only because the state allows them. A corporation is a franchise granting certain rights, a mode of business organization created by a sovereign power.⁸

4. See *infra* notes 18–20, 53–67, 68–83 and accompanying text.

5. 457 U.S. 624 (1982).

6. 794 F.2d 250 (7th Cir. 1986), *cert. granted*, 107 S. Ct. 258 (1986).

7. 796 F.2d 135, 139 (6th Cir. 1986).

8. See *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 409–11 (1819), which observed, "The power of creating a corporation, is one appertaining to sovereignty" *Id.* at 409.

Blackstone discussed corporations purely in these functional terms. He spoke of corporations as “artificial persons, who may maintain a perpetual succession, and enjoy a kind of legal immortality,” which “[had] been found necessary, when it is for the advantage of the public to have any particular rights kept on foot and continued.”⁹ From the earliest times, the role of the sovereign power was essential: “The king’s consent,” he wrote, “is absolutely necessary to the erection of any corporation. . . .”¹⁰

One of the earliest definitions of *corporation*, in a recognizably modern sense, was provided by Chief Justice Marshall in *Dartmouth College v. Woodward*.¹¹ Marshall suggested that a corporation was “an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it. . . .”¹²

A corporation is an independent legal entity. It is independent of and distinct from its members because life is breathed into it by the state. It is a franchise granted as a privilege, and subject to supervision by the chartering sovereign. In 1888, a crucial time for the definition of the modern business corporation,¹³ the Supreme Court made this clear:

[A] franchise is a right, privilege or power of public concern, which ought not be exercised by private individuals at their mere will and pleasure, but should be reserved for public control and administration. . . . Such rights and powers [*i.e.* of independent and perpetual existence] must exist under every form of society. They are always educed from the laws and customs of the community. Under our system, their existence and disposal are under the control of the legislative department of the government, and they cannot be assumed or exercised without legislative authority.¹⁴

Here, with this concept, begins the analysis of corporate rights which culminates in *Cort v. Ash* and *Santa Fe*. The rights of a corporation’s human participants are governed by state law because the corporation is chartered by the state. This is what is meant by the phrase “a corporation is a creature of the state.” If the phrase “a

9. 1 W. BLACKSTONE, COMMENTARIES *467.

10. *Id.* at *472. Blackstone elaborated:

The king’s consent is absolutely necessary to the erection of any corporation, either impliedly or expressly given. . . . The methods, by which the king’s consent is expressly given, are either by act of parliament or charter. . . . So that the immediate creative act is usually performed by the king alone, in virtue of his royal prerogative. . . . All the other methods, therefore, whereby corporations exist, by common law, by prescription, and by act of parliament, are for the most part reducible to this of the king’s letters patent, or charter of incorporation. . . . The parliament, we observe, by its absolute and transcendent authority, may perform this, or any other act whatsoever. . . . The king (it is said) may grant to a subject the power of erecting corporations[,] . . . but it is really the king that erects, and the subject is but the instrument; for though none but the king can make a corporation, yet *qui facit per alium, facit per se* (he who does a thing by the agency of another, does it himself).

Id. at *472–75.

11. 17 U.S. (4 Wheat.) 518 (1819).

12. *Id.* at 636. Justice Story clarified the role of the state by defining the corporation as “a collection of individuals united into one collective body, under a special name, and possessing certain immunities, privileges, and capacities in its collective character, which do not belong to the natural persons composing it.” *Id.* at 667.

13. See *infra* text accompanying notes 27–52.

14. *California v. Pacific R.R. Co.*, 127 U.S. 1, 40 (1888).

creature'' has an archaic ring to it, the formulation can be updated. A corporation is the creation of state law—is created by state law, and therefore is dependent upon it.

Various factors have combined to obscure the chartering government's importance to the corporation. Over the last century, states have become progressively more generous in issuing corporate charters. At the same time, the state's power to investigate the exercise of such powers, or to revoke them outright, through a quo warranto proceeding, has been honored more in the breach than in the observance. The state's role in creating a corporation appears purely ministerial.¹⁵ A corporation might seem a creature of private contract, were it not for that perennial reminder—the need to pay the franchise tax.¹⁶

A second factor has been the tendency of other business entities to imitate the corporation. The rise of the limited partnership has obscured the distinction between the corporation and other forms of business entities. A partnership, because of sophisticated techniques of drafting and valuation, can be given most of a corporation's attributes. The joint venture which finances real estate projects, the thousand-member accounting firm, the group of promoters and tax avoiders associated under Subchapter S of the Internal Revenue Code, all function in ways so similar to the corporation that any economist might dismiss the differences.

A third factor has been the rise of the trading markets and the ostensible divorce of shareholder ownership from executive control. Throughout the modern era, the stock exchanges have become progressively more adept at brokering corporate shares. The geometric growth of the secondary trading market has made the corporation a type of investment fund. Securities seem to exist *a priori*; the existence of the corporate charter seems unrelated to the transfer of a share of stock. Here again, however, the state's action is a *sine qua non*—if state action is not perceived it is because it has already occurred. Corporate securities do not exist of their own right. They exist because a state has chartered the corporation which issued them; they are valuable because the law of the chartering state defines them as valuable and will enforce their attendant rights to payment.

15. The ease with which the corporate form may be adopted has led one writer to argue this point:

Today a group of individuals can create a corporation by drawing up a contract known as articles of incorporation. The articles need contain only certain basic information about the intended activities and initial financing of a new firm. The founders can incorporate in any state, regardless of the location of their principal manufacturing facilities or sales outlets, and the corporation is free to operate in any or all of the other states. After the founders select a state, they submit two copies of the articles to a designated state official, who cannot refuse to certify the articles if they contain the required information.

R. HESSEN, IN DEFENSE OF THE CORPORATION 3 (Hoover Institution Press 1979). See also Anderson & Tollison, *The Myth of the Corporation as a Creature of the State*, 3 INT'L REV. L. & ECON. 107 (1983). See also *infra* text accompanying note 35.

16. The ubiquitous imposition and acceptance of the franchise tax provides evidence of the necessity of the state's role in creating the corporation. It demonstrates that the right to do business in corporate form is so real that businessmen are willing to purchase this right from the state each year.

III. FEDERAL CORPORATE REGULATION: THE HISTORICAL DEBATE

To recognize that a corporation is a creature of the state only begins the analysis. The next question, particularly in a federal system like that of the United States is: To *which* state is the corporation responsible?¹⁷

A. Federal "Charters of Incorporation"

At the Constitutional Convention, James Madison moved that the proposed federal government should have the power "to grant charters of incorporation in cases where the Public good may require them, and the authority of a single State may be incompetent."¹⁸ When this failed to emerge from the committee room, Madison raised the issue again:

Docr. Franklin moved to add after the words "post roads" Art (I) Sect. 8 "a power to provide for cutting canals where deemed necessary"

Mr. Madison suggested an enlargement of the motion into a power "to grant charters of incorporation where the interest of the U.S. might require & the legislative provisions of individual states might be incompetent."¹⁹

Madison and his fellow delegates to the convention were considering economic development in broader terms. The obstacles they saw facing the national economy were not only geographic, but commercial.

The Convention eventually rejected the motion.²⁰ The delegates were aware that leaving business regulation primarily to the individual states might cause friction within the overall American economy. They were more reluctant, however, to allow concentrations of economic power, which they visualized as a government-sponsored monopoly, and therefore chose this course. The contemporary argument is that state corporation law is invalid if it operates to inhibit trafficking in securities because of the negative sweep of the Commerce Clause. James Wilson made the same argument when he sought to bring incorporation within the federal ambit in order to minimize commercial friction.²¹ He obviously felt that the Commerce Clause did not prevent state corporation law from having an impact on interstate commerce and wanted to

17. Since the existence of a corporation consists as much in the recognition by the courts that a corporation exists as in the fact that a charter has been issued, the argument can be made that any state whose courts recognize the existence of a corporation thereby assumes a sovereign's authority over it. Chief Justice Marshall avoided this line of thinking by reasoning: "In America, the powers of sovereignty are divided between the government of the Union, and those of the States. They are each sovereign, with respect to the objects committed to it, and neither sovereign with respect to the powers committed to the other." *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 410 (1819).

18. 3 M. FARRAND, *RECORDS OF THE FEDERAL CONVENTION OF 1787*, at 325 (1911). Thomas Pinkney also had moved, more broadly, that the power should be given "to grant charters of incorporation." *Id.*

19. *Id.* at 615.

20. *Id.* at 616-17.

21. This colloquy was as follows:

Mr. King thought the motion unnecessary.

Mr. Wilson. It is necessary to prevent a State from obstructing the general welfare . . .

Col. Mason was for limiting the power . . . to Canals. He was afraid of monopolies of every sort. . . .

Id.

eliminate this potential problem. The Convention's rejection of his views evinces even more clearly a decision not to federalize the area.²²

At the time of the Constitutional Convention, corporations represented a small but expanding fraction of the nation's economy.²³ The quasi-public nature of the great majority of these corporations—bridge, road, canal, navigation, banking, insurance, and utility companies—was readily apparent. When the Founders thought of corporations, they thought of quasi-governmental, quasi-sovereign entities. Their antecedents were religious corporations and the English commercial companies such as the Bank of England, the Hudson's Bay Company, the South Sea Company, the Royal Exchange, and the London (Marine) Assurance Company. Convention delegates had such entities in mind when they referred to "reducing the States to mere corporations."²⁴ The corporations of their day were hybrids, something less than a state, yet far more than a simple business enterprise.

The public authority—indeed, the grants of limited sovereignty—afforded such institutions is reflected in the method by which they were created. In this era, creation of a corporation required a specific act of the state.²⁵ Justice Brandeis outlined the reasons:

Although the value of [the corporation] in commerce and industry was fully recognized, incorporation for business was commonly denied long after it had been freely granted for religious, educational, and charitable purposes. It was denied because of fear. Fear of encroachment upon the liberties and opportunities of the individual. Fear of the subjection of labor to capital. Fear of monopoly. Fear that the absorption of capital by corporations, and their perpetual life, might bring evils similar to those which attended mortmain. There was a sense of some insidious menace inherent in large aggregations of capital, particularly when held by corporations. Thus, the corporate privilege was first granted only sparingly; and only when the grant seemed necessary to procure for the community some specific benefit otherwise unattainable.²⁶

22. Alexander Hamilton was seldom canner and more disingenuous than when he summarized the Convention's decision on this issue. Arguing for the creation of the National Bank, he admitted that there had been a "rejection of a proposal to empower Congress to make corporations" and dismissed this as irrelevant:

The precise nature and extent of this proposition, and the reasons for refusing it, are not ascertained by any authentic document, or even by accurate recollection. As far as any such document exists, it specifies only canals. . . . It must be confessed, however, that very different accounts are given of the import of the proposition, and of the motives for rejecting it. Some affirm that it was confined to the opening of canals and obstructions in rivers; others, that it embraced banks; and others, that it extended to the power of incorporating generally. Some, again, allege that it was disagreed to because it was thought improper to vest in Congress a power of erecting corporations. Others, because it was thought unnecessary to *specify* the power, and inexpedient to furnish an additional topic of objection to the Constitution. In this state of the matter, no inference whatever can be drawn from it.

3 M. FARRAND, *supra* note 18, Appendix A, at CCLX (emphasis added). Madison's recollections, however confirm that the matter was not so inconclusive. "He well recollected that a power to grant charters of incorporation had been proposed in the General Convention and been rejected." *Id.*, Appendix A, at CCLVII.

23. See Wilgus, *Need of a National Incorporation Law*, 2 MICH. L. REV. 358, 362–63 (1904).

24. 3 M. FARRAND, *supra* note 18, at 362.

25. See Jacobson, *The Private Use of Public Authority: Sovereignty and Associations in the Common Law*, 29 BUFFALO L. REV. 599 (1980), which argues that "the state apparatus in our tradition distributes a portion of sovereignty to persons not formally subject to bureaucratic control," and that this "distribution generates a series of legal institutions—agency, partnership," and all other forms of business associations—so that, essentially, any form of business affiliation is a use of sovereignty. *Id.* at 600–03.

26. Louis K. Liggett Co. v. Lee, 288 U.S. 517, 548–49 (1933) (Brandeis, J., dissenting).

1. *The Corporate Revolution of the Nineteenth Century*

The first change in this pattern came well within the Founders' lifetimes. By 1800 New York, Pennsylvania, and Delaware had enacted the first modern corporation statutes—general incorporation laws which permitted any association which qualified and registered to receive corporate status.²⁷ Developing this theme, the states abolished the special franchises upon which the quasi-governmental corporation had been built. By 1846, New York had adopted a constitution that required incorporation under general laws. By 1861, nearly every industrial state had followed New York's lead, and by the end of Reconstruction, general incorporation laws were nearly universal.²⁸

The last half of the Nineteenth Century witnessed a dramatic change in the function and purposes of the corporation; the era might well be identified as the "Corporate Revolution." The first stage had been the adoption of general incorporation laws which facilitated the use of the corporate form. The second stage was the apparent deregulation of the corporations formed under these general laws. Between the Civil War and World War I, the size of corporations increased as state legislatures repeatedly raised (and finally abolished) limits on the authorized capital of business corporations.²⁹ Corporations historically had been confined to statutory ceilings on indebtedness. These restrictions were largely eliminated by the turn of the century.³⁰

Originally, even under the general laws, the corporate form could be used "only for a limited number of purposes—usually those which required a relatively large fixed capital, like transportation, banking, and insurance, and mechanical, mining and manufacturing enterprises."³¹ By 1875, however, it had become common to incorporate for "any lawful purpose."³² The corporate lifespan had generally been limited to twenty, thirty or fifty years.³³ Now, as such laws were repealed, corporations became immortal. The national corporation came into being. It was no longer obligatory that incorporators be residents of the chartering state and corporations acquired the power to hold stock in other corporations, making possible the holding company and the many-tiered corporate pyramid.³⁴

By the turn of the century the modern business corporation had been established.³⁵ The difference between this entity and its predecessors equalled the

27. Wilgus, *supra* note 23, at 362–63. These laws at first were primarily used by charitable and religious corporations.

28. *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 594 n.5 (1933).

29. *Id.* at 550–54, nn.5–26. The most succinct summary of the corporate revolution is Justice Brandeis' dissent in *Louis K. Liggett Co. v. Lee*. *Id.* at 541–80.

30. *Id.* at 555–56 n.31.

31. *Id.* at 554–55.

32. *Id.* at 555 n.28.

33. *Id.* at 555 n.29.

34. *Cf. id.* at 555–56 nn.30 & 32.

35. Professors Gary M. Anderson and Robert D. Tollison, in an article titled *The Myth of the Corporation as a Creation of the State*, 3 *INT'L REV. L. & ECON.* 107 (1983), have argued, very plausibly, that in passing these liberalized incorporation laws, governments were responding to businessmen's demands for a business entity with "the characteristics of *corporateness* (i.e. share transferability, limited liability, the separation of management from ownership, and so on)." *Id.* at 109 (emphasis added).

Anderson and Tollison's evidence is concerned almost exclusively with English business firms between 1720 and 1825. Examining the surviving records of unincorporated joint-stock companies (as compared to incorporated firms) they concluded that for these companies, as for the modern megapartnership, "incorporation was not a necessary step in

difference between the British East India Company and General Motors. By making incorporation easy, expanding corporate powers, and providing for perpetual corporate life, the states seemed to have abdicated control. Moreover, the national scope of the modern corporations' activities suggested that state regulation of them might be barred by the Commerce Clause. In short, the corporations seemed to have outgrown the authority of the states.

The United States Supreme Court dispelled the suggestion that corporations had shed the bonds of state authority by holding that corporations had *not* been emancipated. In a series of cases decided between 1889 and 1905,³⁶ the Court provided a comprehensive explanation of the rationale. The Court first highlighted the principle that a corporation is a creature of the state—chartered pursuant to a state's law. A corporation has only those rights and powers which the state chooses to give it. Because the state creates those rights and powers, the state may award them subject to any condition it chooses. And in doing so—in limiting powers, or in making them conditional—the state does *not* burden interstate commerce. Such limitations are not infringements of some absolute right to do business through a corporation, but rather are the terms upon which businessmen accept the opportunity to transact business in the corporate form.

2. The Judicial Response

The Supreme Court began to define the modern business corporation in *Oregon Ry. and Navigation Co. v. Oregonian Ry. Co.*³⁷ At issue was whether a railroad company had the power to lease another railroad's rail lines. Justice Miller observed: "[I]t is the established doctrine of this court . . . that [a] corporation can exercise no power or authority which is not granted to it by the charter under which it exists or by some other act of the legislature which granted that charter."³⁸

order . . . to acquire the characteristics of a corporation." *Id.* at 111. Joint-stock companies achieved perpetual existence and legal identity, of a sort, by assigning the group's rights and property to trustees. They sometimes attempted to achieve limited liability for participants through specifying this in their articles of association, adding clauses to this effect to their business contracts, or by relying upon local custom. *Id.* at 114.

The article's conclusion is that 18th-Century entrepreneurs, rather than 19th-Century legislators, were the first to recognize the corporation's value as a commercial vehicle. "The legislative availability of cheap and simple incorporation was not the stimulus to the expansion of the corporate form, but merely a response to previous developments." *Id.* at 116. The initiative came from this business community, Anderson and Tollison argue—in *this* sense, the corporation is a creation of business, not of the state.

Historically, this seems entirely accurate, but it does not redefine the state's *legal* role in the creation of the modern corporation. Anderson and Tollison observe that the trustee form of operations was cumbersome, that the costs of limited liability (and, presumably, transferability of shares) were petitioning Parliament and inviting government scrutiny. *Id.* at 110–12. Although they speak of joint-stock firms as "unincorporated corporations," *id.* at 116, this blurs matters too much; the differences are too substantial. Form cannot be ignored; the corporation provides what other business entities struggle to attain. The difference is the state's concession to recognize the existence of a legal personage—which is what it does, in 1720 and in 1987—when it grants a corporate charter.

Anderson and Tollison's argument, in fact, goes far to portray the business corporations which emerged in the 19th Century as an entirely new breed, economically transfigured, given legal identity, perpetual existence, and limited liability by the states which issued their corporate charters. From this perspective, the cases which define the state's role in the corporation are even more important. They must be read not merely as cases reaffirming or reapplying existing doctrine, but as establishing new principles in a new area of the law.

36. See *infra* text accompanying notes 37–40.

37. 130 U.S. 1 (1889).

38. *Id.* at 20–21.

Two years later, the Court elaborated upon this statement. It explicitly noted that the state not only defines a corporation's powers, but also exercises, even under general incorporation statutes, a discretionary role in allowing incorporation:

By the term 'corporate franchise or business,' . . . we understand is meant . . . the right or privilege given by the State to two or more persons of being a corporation, that is of doing business in a corporate capacity The granting of such right or privilege rests entirely in the discretion of the State, and, of course, when granted, may be accompanied with such conditions as its legislature may judge most befitting to its interests and policy.³⁹

This formulation was reaffirmed fifteen years later, in what has become the leading statement of the rule:

[T]he corporation is a creature of the state. It is presumed to be incorporated for the benefit of the public. It receives certain privileges and franchises, and holds them subject to the laws of the State and the limitations of its charter. Its powers are limited by law. It can make no contract not authorized by its charter. Its rights to act as a corporation are only preserved to it so long as it obeys the laws of its creation. There is a reserved right in the legislature to investigate its contracts and find out whether it has exceeded its powers.⁴⁰

The Commerce Clause issue first received primary attention in 1894. In *Ashley v. Ryan*,⁴¹ the Supreme Court held that the conditions which the state may attach to the privilege of incorporation, however substantial, do not burden interstate commerce. They are, instead, the prerequisites for use of the corporate form.

Ashley v. Ryan involved a railroad consolidation. Five Midwestern railroad companies, chartered in Missouri, Michigan, Illinois, Indiana, and Ohio, sought to consolidate themselves into one Ohio corporation. Ohio charged an incorporation fee of one-tenth of one percent of the corporation's capital stock. The new firm's incorporators tendered \$700, one tenth of one percent of the capital stock of the Ohio company being consolidated. The State of Ohio, however, demanded a fee of \$52,000, based on the capital stock of the entire consolidated company. The corporation paid under protest and sued, claiming that Ohio's means of measuring the fee represented a burden on interstate commerce and an extraterritorial application of the Ohio tax law.

The United States Supreme Court, dealing specifically with these issues, upheld Ohio's interpretation of the law:

A state's right to impose conditions upon the use of the corporate franchise, however, is subject to certain limitations. It would be impermissible, for example, for a state to impose conditions which denied equal protection of the laws upon applicants for corporate charters. *See, e.g., Berea College v. Kentucky*, 211 U.S. 45 (1908).

39. *Home Ins. Co. v. New York*, 134 U.S. 594, 599-600 (1890). *See also Horn Silver Mining Co. v. New York*, 143 U.S. 305 (1892) (finding it settled that the state has the power to tax a corporation chartered under the state's general laws).

40. *Hale v. Henkel*, 201 U.S. 43, 74-75 (1906). In another early case, the Court had explained that this "reserved right" was due to "the power which the state has, and, upon every ground of public policy, must always have, over corporations of her own creation." *Chicago Life Ins. Co. v. Needles*, 113 U.S. 574, 579-80 (1885).

It is important to note that the authority of the state over the corporations that it charters does not mean that federal regulation is thereby foreclosed. This argument was specifically rejected by the Supreme Court in *Northern Securities Co. v. United States*, 193 U.S. 197 (1904). *See infra* text accompanying notes 47-52. State law should stand, however, in the absence of conflicting federal legislation.

41. 153 U.S. 436 (1894).

The question here is not the power of the State of Ohio to lay a charge on interstate commerce, or to prevent a foreign corporation from engaging in interstate commerce within its confines, but simply the right of the State to determine upon what conditions its laws as to the consolidation of corporations may be availed of.

[T]he payment of the charge was a condition imposed by the State of Ohio upon the taking of corporate being or the exercise of corporate franchises, the right to which depended solely upon the will of that State, and hence . . . liability for the charge was entirely optional [T]he exaction constituted no tax upon interstate commerce, or the right to carry on the same, or the instruments thereof, and . . . its enforcement involved no attempt on the part of the State to extend its taxing power beyond its territorial limits.⁴²

The same point was made more explicitly in *Louisville & Nashville R.R. Co. v. Kentucky*.⁴³ This case also involved a railroad consolidation. The Louisville & Nashville Railroad sought to acquire the franchises and assets of two competing railroad systems in contravention of the Kentucky state constitution. The State of Kentucky sued to enjoin this takeover. The railroad argued that to forbid such a consolidation of competing rail lines would interfere with interstate commerce.⁴⁴ The Supreme Court sharply rejected this argument:

It results then, from the argument of the [railroad] that, if there be any interference with interstate commerce it is in imposing limitations upon the exercise of a right which did not previously exist, and hence, if the State permits such purchase of consolidation, it is bound to extend the authority to every possible case, or expose itself to the charge of interfering with commerce. This proposition is obviously untenable.⁴⁵

Louisville & Nashville R.R. emphasizes the point made in *Ashley v. Ryan*: There is no absolute right to do business in the corporate form and no constitutional right to be able to do whatever one wishes with a corporation. A corporation receives only those powers which the state chooses to give it. If the corporation does not receive unqualified powers, it cannot complain. The Commerce Clause does not require a state to extend every possible power to the corporation. Nor does it give the management of a corporation the right to circumvent troublesome state laws by invoking the Commerce Clause.⁴⁶

42. *Id.* at 446. A cluster of subsequent cases reiterated the analysis. *See, e.g.,* *Interstate Consol. Street Ry. Co. v. Massachusetts*, 207 U.S. 79, 84 (1907); *Kansas City, Memphis & Birmingham R.R. Co. v. Stiles*, 242 U.S. 111, 117 (1916); *Motion Picture Patents Co. v. Universal Films Mfg. Co.*, 243 U.S. 502, 519 (1917) (Holmes, J., dissenting); *Denver v. Denver Union Water Co.*, 246 U.S. 178, 197 (1918) (Holmes, J., dissenting).

43. 161 U.S. 677 (1896).

44. Also at issue was whether the state constitution, adopted subsequent to the chartering of the railroad, was binding upon the Louisville & Nashville. The Supreme Court held that it was. The Railroad's charter reserved no power to the state to amend it by subsequent action. Nonetheless, because "railways [are] public highways, and their functions [are] those of the State, though their ownership [is] private," 161 U.S. 676, 697 (1896), and because of the state's capacity, under the police power, to "provide, by reasonable regulations, against the misuse of special corporate privileges which it had granted," the state could forbid consolidation if it felt such consolidation would harm the public interest. *Id.* at 696-97.

45. 161 U.S. 677, 703 (1896).

46. The idea that the police power allows the states to regulate the instruments of interstate commerce seems, at first, to have been dealt a fatal blow by *Southern Pacific R.R. Co. v. Arizona*, 325 U.S. 761 (1945), which struck down state restrictions on the length of trains moving across its borders. *Id.* at 783-84. This is not the final word, however, for even in *Southern Pacific*, the Court conceded that "in the absence of conflicting legislation by Congress, there is a

The state's control over internal corporate affairs was reiterated in *Northern Securities Co. v. United States*.⁴⁷ In an antitrust action, the United States charged that the Northern Securities Company (Northern Securities) had created a monopoly by acquiring majority interests in two competing railroads. The corporation's articles specifically gave Northern Securities the power to purchase, hold, and act as the owner of the shares of the other corporations.⁴⁸

Northern Securities' argument was based upon the converse of the *Louisville & Nashville R.R.* holding. Northern Securities argued that the creation of railroad companies, and the definition of their powers, had always been matters of state jurisdiction. Accordingly, if a state gave a corporation the power to hold stock in other corporations, that firm could buy the shares of other railroads, effect a de facto consolidation, and the federal government could not interfere. In effect, the chartering state could authorize creation of a monopoly.⁴⁹ Justice Harlan, speaking for the court, emphatically rejected this argument:

We are confronted with the suggestion that any order or decree . . . which will prevent [National Securities] from exercising the powers it acquired in becoming the holder of the stocks of the Great Northern and Northern Pacific Railway Companies will be an invasion of the rights of the State under which the Securities Company was chartered. . . . No such view can be entertained for a moment.⁵⁰

The Court distinguished *Louisville & Nashville R.R.*, asserting that the earlier decision reserved to the states the power only to regulate the *instruments* of interstate commerce. "If there is anything in that case which even intimates that a State or a state corporation may in any way directly restrain interstate commerce . . . we have been unable to find it."⁵¹ The *Northern Securities* Court, in upholding the antitrust laws, ruled that state incorporation statutes could not be used to immunize monopolies against the federal government's power over interstate commerce.

While achieving this outcome, the Court specifically reserved to the states the regulation of corporate internal affairs. The corporation's role in interstate commerce was subject to federal regulation, but the corporation itself remained a creature of the chartering state: "So far as the Constitution of the United States is concerned, a State may indeed create a corporation, define its powers, prescribe the amount of its stock and the mode in which it may be transferred."⁵²

residuum of power in the state to make laws governing matters of local concern which nevertheless in some measure affect interstate commerce. . . ." *Id.* at 767.

The true answer seems to be that when Congress has not preempted the field, the states may use the police power to regulate the basic vehicles of interstate commerce. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117 (1973); *Brotherhood of Locomotive Firemen & Enginemen v. Chicago, Rock Island and Pacific R.R.*, 393 U.S. 129 (1968); *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440 (1960). A corporation chartered by state law is as much an instrument of interstate commerce as is a train, and in both cases it is the police power which the state employs to protect the public—against the unsafe operation of heavy machinery in one case and the machinations of unscrupulous promoters in the other.

47. 193 U.S. 197 (1904).

48. *Id.* at 207–08.

49. *Id.* at 273–74.

50. *Id.* at 344–45.

51. *Id.* at 348–49.

52. *Id.* at 346.

Northern Securities fixed the jurisdictional boundaries of federal-state relations in the corporate area. The case made clear that the federal government would not be hindered in policing interstate commerce by state corporation law. At the same time, the regulation of the corporation's internal affairs was reserved to the states.

Two related factors are critical to this outcome. The first is the presence of federal legislation in this area of interstate commerce. Except for the presence of federal antitrust law, *Northern Securities'* charter rights would have allowed it to function as a holding company. (There has never been any suggestion that the Commerce Clause forbids monopolization by state-chartered corporations—if it did there would be no need for antitrust laws.) The second is the inapplicability of any other law, except that of the chartering state, in the area of intracorporate governance. To establish the method of transferring the firm's shares, to say what powers it may exercise, to set the amount of its capital—if the law of the chartering state is not held to control these, no law does, and there would be no corporation at all. Certainly, and crucially, no federal law exists in the area of incorporation.

3. *The Incorporation Debate During the Progressive Era*

The Supreme Court, in ruling that corporations should be regulated by the states which chartered them, implicitly rejected the option of federal control. It could not have been ignorant of this alternative.⁵³ In the era of *Ashley v. Ryan, Louisville & Nashville R.R.*, and *Northern Securities*, the idea that the federal government should regulate corporations was receiving wide endorsement among the populace and academics, and from Washington officials. One of the reasons for the furor was that "the United States Supreme Court [had referred] such matters [the question of corporate governance in a national economy] back to the states."⁵⁴

In 1898 Congress established the Industrial Commission, a body charged with investigating and proposing national policy on a variety of industrial and commercial issues.⁵⁵ In its final report in 1902, the Commission recommended "corporation laws which should provide for a greater degree of publicity regarding the affairs of corporations," concluding that "[f]ederal supervision, under some form, which may control the combinations doing an interstate business, is therefore of chief importance." If other means of control failed to curb corporate abuses, the Commission believed that "it may be wise for the Congress to enact a Federal incorporation law," and require federal rechartering for all corporations engaged in interstate commerce. "When organized under a Federal law it would be possible . . . to apply to corporations any degree of publicity or restriction that might be authorized."⁵⁶

53. Indeed, in 1902, the Court gave its "general approval" to the declaration that "it was never the policy of the Federal government to interfere with the policy of the State in reference to the formation and development of such corporations as it should judge expedient" *Jenkins v. Neff*, 186 U.S. 230, 237 (1902).

54. Dill, *National Incorporation Laws for Trusts*, 11 *YALE L.J.* 273, 277 (1902).

55. I L. LOSS, *SECURITIES REGULATION* 107 (2d ed. 1961), citing 30 Stat. 476 (1898).

56. U.S. INDUSTRIAL COMMISSION, FINAL REPORT 643, 652 (1902), reprinted at 69-A *FTC Utility Corporations*, S. Doc. No. 92, 70th Cong., 1st Sess. 23-25 (1934). See also L. LOSS, *supra* note 55, at 107-09; Note, *Federal Chartering of Corporations: Constitutional Challenges*, 61 *Geo. L.J.* 123, 126-27 (1972).

In 1903 a Bureau of Corporations was made part of the Department of Commerce and Labor. The Commissioner's first report—issued in 1904, the same year as *Northern Securities*—called for “the granting of a Federal franchise or license to engage in interstate commerce,” and “the prohibition of all corporations . . . from engaging in interstate and foreign commerce without such Federal franchise or license.”⁵⁷ Subsequently, “[s]ubstantially the same recommendation (or, in later years, a scheme of compulsory publicity) was repeated in every annual report” until the Bureau of Corporations was absorbed into the Federal Trade Commission in 1914.⁵⁸

Federal incorporation or licensing was called for by Presidents Theodore Roosevelt,⁵⁹ Taft,⁶⁰ and Wilson.⁶¹ Congress also undertook to deal with the issue. Between 1903 and 1914, twenty bills were introduced on the floors of both houses.⁶² At one point, it was suggested that a Constitutional amendment be employed.⁶³ In the field of legal scholarship, federal incorporation was one of the most popular topics, and occasionally one of the most hotly disputed.⁶⁴

57. *Report of Commissioner of Corporations*, H.R. Doc. No. 165, 58th Cong., 2d Sess. 45, 47–48 (1904), reprinted at 69-A FTC, *supra* note 56, at 4–5.

In discussing the interstate commerce ramifications of federal franchising, Commissioner James R. Garfield examined the effect of such federal action upon “local matters left to the regulation of the states.” The unstated assumption of his argument is that state regulation would stand in the absence of federal legislation. *Id.*, Appendix B, at 56–57, reprinted at 69-A FTC, *supra* note 56, at 5–6.

58. 1 L. LOSS, *supra* note 55, at 108–09, citing COMMISSIONER OF CORPORATIONS ANNUAL REPORT (1905) 8–9; *id.* (1906) 5–7; *id.* (1907) 6–7; *id.* (1908) 6–10; *id.* (1909) 3–6; *id.* (1910) 5–7; *id.* (1911) 3–4; *id.* (1912) 8–10, 14–15 (summarizing the previous decade's recommendations); *id.* (1913) 7; *id.* (1914) 3–12 (summarizing the history of the Bureau of Corporations). (Dates refer to fiscal years, except for 1904 and 1905; all reports were published a year later).

59. See 69-A FTC, *supra* note 56, at 18.

60. Federal control was much mooted during the Taft Administration. In 1910 and 1911, Taft sent two messages to Congress on the subject, and Attorney General Wickersham argued at length in favor of federal incorporation. See 69-A FTC, *supra* note 56, at 16–19; 1 L. LOSS, *supra* note 55, at 109, citing 16 MESSAGES AND PAPERS OF THE PRESIDENTS 7455, 7457, 7522 (1910); 17 MESSAGES AND PAPERS OF THE PRESIDENTS at 7652, 7654 (1911).

61. 69-A FTC, *supra* note 56, at 17. Wilson had long been concerned with the issue. In his inaugural address as governor of New Jersey, he declared:

A corporation exists, not of natural right, but only by license of law, and the law, if we look at the matter in good conscience, is responsible for what it creates. . . . If law is at liberty to adjust the general conditions of society itself, it is at liberty to control these great instrumentalities which nowadays, in so large part, determine the character of society.

II PUBLIC PAPERS OF WOODROW WILSON 273–75 (Baker and Dodd eds. 1925), quoted in *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 559 n.37 (1933).

62. See 69-A FTC, *supra* note 56, at 32–41.

63. Andrews, *Considerations for A Sixteenth Amendment*, 69 ALB. L.H. 363 (1907), reprinted at 69-A FTC, *supra* note 56, 115–117.

64. See Huffcutt, *Constitutional Aspects of the Federal Control of Corporations*, 8 AMER. LAW. 111 (1900); Huffcutt, *Federal Control of Corporations*, 34 AMER. L. REV. 186 (1900); Mosby, *The Corporation System—An Argument for Its Abolition*, 34 AMER. L. REV. 544 (1900); Dill, *National Incorporation for Companies Engaged in Interstate Commerce*, 27 NAT. CORP. REP. 376, 11 AMER. LAW. 285 (1903); Randolph, *State Corporations in Federal and Interstate Commerce*, 3 COLUM. L. REV. 168, 221 (1903); Wilgus, *Need of a National Corporation Law*, 2 MICH. L. REV. 358 (1904); Wilgus, *A Proposed National Incorporation Law*, 2 MICH. L. REV. 501 (1904); Thacher, *Federal Control of Corporations*, 14 YALE L.J. 301 (1905); Smith, *Incorporation by the Corporations—A Dangerous Departure*, 17 GREEN BAG 135 (1905); Curtis, *Federal Control of Corporations—A Public Necessity*, 17 GREEN BAG 138 (1905); James, *Federal License or National Incorporation*, 3 MICH. L. REV. 415 (1905); Chaplin, *National Incorporation*, 5 COLUM. L. REV. 415 (1905); Cutting, *Regulation of Corporations by Federal Law*, 67 ALB. L.J. 39 (1905); Prentice, *Congress and the Regulation of Corporations*, 19 HARV. L. REV. 168 (1906); Coudert, *Constitutional Limitations on the Regulation of Corporations*, 6 COLUM. L. REV. 485 (1906); Judson, *The Control of Corporations*, 18 GREEN BAG 662 (1906); Bennett, *Corporations and the Commerce Clause*, 52 OHIO L. B. 379 (1907); Thacher, *Corporations and the States*, 17 YALE L.J. 98 (1907); Thacher, *The Basis of the Right to Regulate Corporations*, 18 YALE L. J. 263 (1909); Snapes, *National Incorporation*, 5 ILL. L. REV.

What strikes one as remarkable about the popular debate,⁶⁵ as it took shape in the country's convention halls and newspapers, is the broad range of support for federal incorporation. The spectrum stretched so far as to include both Judge E. H. Gary, chairman of U.S. Steel, and William Jennings Bryan.⁶⁶ Addressing the 1899 Chicago Conference on Trusts, Bryan spoke with his customary color:

The method that occurs to me is this: That Congress should pass a law providing that no corporation organized in any State should do business outside of the State in which it is organized until it receives from some power created by Congress a license authorizing it to do business outside of its own state

My contention is that the government that created must retain control, and that the man-made man must be admonished: "Remember now thy Creator in the days of thy youth—and throughout thy entire life"

What government gives, the government can take away. What the government creates, it can control; and I insist that both the State government and the Federal government must protect the God-made man from the man-made man.⁶⁷

Neither Bryan's oratory, nor the concern of statesmen, nor the analysis of professors, nor the interest of business, produced any change.

The federal incorporation bills seldom escaped the committees to which they were referred. The era of Populism, Theodore Roosevelt, and Woodrow Wilson, which produced the Sherman and Clayton Acts, the Pure Food and Drug Act, and the Federal Trade Commission, considered the matter, but ultimately chose to leave corporation law under state authority.

4. *New Deal Investigations and Proposals*

Interest in the federal chartering of corporations revived two decades later during the New Deal.⁶⁸ The debate began early in the first Roosevelt administration and it did not abate until 1941. However, despite the initiatives taken by both Congress and the executive branch, the federal government again declined to federalize corporation law.

414 (1911); Baker, *Regulation of Industrial Corporations*, 22 *YALE L. J.* 306 (1913); Watkins, *Federal Incorporation*, 17 *MICH. L. REV.* 64 (1918).

Most of the academic lawyers who studied the issue (the above listing is only a partial bibliography) favored federal incorporation or licensing. Prominent among them were Wilgus, Chaplin, Coudert, Baker, and Watkins. Prentice and Thacher called for regulation by the states. A full bibliography of the turn-of-the century debate is provided at 69-A FTC, *supra* note 56, at 137-43.

65. In a very literal sense. So frequently did the topic arise in forensic competitions, apparently, that one Edith M. Phelps prepared, as an entry in the *DEBATER'S HANDBOOK SERIES*, *Selected Articles on Federal Control of Interstate Corporations*. By 1915 it was in its second edition. See 69-A FTC, *supra* note 56, at 117-21, 141.

66. 69-A FTC, *supra* note 56, at 22, 133. Judge Gary saw in federal licensing something that would be good for the country and good for U.S. Steel: "The system of elective licensing of big corporations permitting them to take licenses if they wish and giving them immunity from prosecution under the antitrust laws while they comply with the regulations of the license seems to be the next step in Government regulation of business." *Id.* at 22. In 1915, the National Association of Manufacturers gave a "hearty response" to the suggestion of federal incorporation. *Id.* at 123.

67. *Id.* at 102-03.

68. Between 1919 and 1932, only eight bills dealing with federal licensing or incorporation were introduced in Congress. Only one of these would have made federal licensing mandatory for corporations carrying on interstate commerce. S. REP. NO. 2847, 71st Cong., 2d Sess. (Jan. 6, 1930). The primary focus of several were related issues such as securities sales, interlocking directorates, and commodity monopolization. See 69-A FTC, *supra* note 56, at 42.

Shortly after Franklin Delano Roosevelt was inaugurated, a special study committee within the Department of Commerce undertook an investigation of the financial abuses which had helped facilitate the Crash of 1929. The work of this committee formed the basis for the Presidential recommendations which became the Securities Act of 1933 and the Securities Exchange Act of 1934. Given the pervasiveness of federal regulation of the securities area, it is surprising that the final document produced by this committee, the Roper and Dickerson Reports, concluded that federal incorporation would be more effective than stock-exchange regulation at policing financial abuses.⁶⁹ When federal legislation was enacted, it followed this pattern. Nonetheless, the Securities Exchange Act of 1934 explicitly allowed state regulation of securities transactions. In Section 28(a)⁷⁰ Congress carefully circumscribed the Act's scope: "Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State or any person insofar as it does not conflict with the provisions of this chapter or the rules or regulations hereunder."⁷¹ This language suggests that the section was meant to protect, rather than to limit, state authority to regulate in the securities area.

In the late 1930s, questions of federal control over corporations were taken up again, by the Temporary National Economic Committee (TNEC), which had been authorized to make a national study of financial control and concentrations of economic power. In 1941 the Committee issued its final report. Under the heading of "General Economic Problems," it called for "national standards for national corporations."⁷²

Four members of the TNEC dissented from this section of the report. The principal reason for their disagreement was a feeling that the recommendations were vague and "naively assume[d] that the so-called national standards [would] be self-executing." Significantly, the committee noted that "[w]ithout determining precisely what standards of corporate practice should be imposed, a recommendation

69. "Stock Exchange Regulations," Letter from the President of the United States to the Chairman of the Senate Banking and Currency Committee, with an Accompanying Report Relative to Stock Exchange Regulation (January 25, 1934). *Roper Report & Dickerson Report*, S. COMM. PRINT, 73d Cong., 2d Sess. 4 (1934), reprinted in *LEGISLATIVE HISTORY OF THE SECURITIES EXCHANGE ACT OF 1934*, vol. 4, item 16, p. 4.

During Senate hearings on the 1934 act, the President of the New York Stock Exchange, Richard Whitney, argued: "The apparent purpose of [the bill] is to correct the abuses in corporate procedure which exist today because of the inadequacy of state laws. The remedy for this situation is a national incorporation law applicable to all companies doing business in interstate commerce. This should be accomplished by direct Federal legislation." *Stock Exchange Practices, Hearings on S. Res. 84 before the Senate Comm. on Banking and Currency* (72d Cong.) and *S. Res. 56 and S. Res. 97* (73d Cong.) 6583, reprinted in *LEGISLATIVE HISTORY OF THE SECURITIES EXCHANGE ACT OF 1934*, vol. 6, item 22, p. 6583. See also *id.* at 6538, 6637, 6715-16, 6939. Mr. Whitney was not entirely a disinterested witness; doubtless he wanted to keep federal regulation out of the exchange he ran by shifting it to the companies whose shares were traded there.

In 1938 the SEC endorsed federal chartering as a possible solution to the perceived problem of corporate charter-mongering by such states as Delaware. 1 L. LOSS, *supra* note 55, at 110 n.17, citing 7 SEC. *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protection and Reorganization Committees* 412-13 (1938).

70. 15 U.S.C. § 78bb(a) (1985).

71. *Id.* The purpose was "to leave the States with as much leeway to regulate securities transactions as the Supremacy Clause would allow them in the absence of such a provision." *Leroy v. Great Western United Corp.*, 443 U.S. 173, 182 n.13 (1979).

72. TEMPORARY NATIONAL ECONOMIC COMMITTEE, FINAL REPORT AND RECOMMENDATIONS, SEN. DOC. NO. 35, 77th Cong., 1st Sess. 24 (1941).

that 'national standards for national corporations' be adopted is not meaningful."⁷³ They thus recognized that the federalization of corporate law would necessarily depend upon the willingness of the federal government to establish the basic rules governing business associations.

Congressional action was contemporaneous. Beginning in 1935, Senators Borah and O'Mahoney introduced a series of bills calling for either licensing or incorporation of corporations engaged in interstate commerce.⁷⁴ Senator O'Mahoney (the head of the TNEC) was identified more prominently with this issue than any other politician of the era and in 1937 held extensive hearings on two bills, S. 10 and S. 3072, which were later revised into S. 330.⁷⁵

The purpose of the O'Mahoney legislation was to complement the securities acts already passed, thereby completing the federalization of business law. Sales of securities to the public had been brought under federal control by the Securities Act of 1933, and secondary trading practices and the stock markets themselves were subject to federal regulation under the Securities Exchange Act of 1934. The final area in which the public needed protection against corporate mismanagement and self-dealing, it was felt, was corporate internal affairs.

The bill was meant to strike at the roots of business abuses by limiting the powers corporate officers could exercise—preventing rather than remedying problems. O'Mahoney clearly intended to regulate at the source. "What we are trying to do is find a way to write the rules for the national corporations," he stated.⁷⁶ "[S]ince we recognize and must recognize that this national commerce is carried on by national corporations, it should be the Federal Government and not the State governments which may describe and outline the powers of the corporations which carry it on. . . . [W]hen corporations began to come into being as instrumentalities of commerce, in almost all instances every corporation had to receive a special charter from the legislature."⁷⁷

The substantive provisions of the O'Mahoney legislation, had it been enacted, would have changed the face of American corporation law. The bill would have required, as a condition of federal licensing, that a corporation file reports (containing information similar to that furnished by companies reporting under the Securities Exchange Act) with the Federal Trade Commission.⁷⁸ The bill also prescribed standards for the fiduciary duty of licensed corporations' officers and directors.

73. *Id.* at 30.

74. S. 3363, 74th Cong., 1st Sess. (1935); S. 10, 75th Cong., 1st Sess. (1937); S. 3072, 75th Cong., 3d Sess. (1938); S. 330, 76th Cong., 1st Sess. (1939).

75. Senator O'Mahoney introduced similar legislation in every Congress through 1949. *See* O'Mahoney, *Federal Charters to Save Free Enterprise*, 1949 Wis. L. Rev. 407, 415 (1949).

For an overview of New Deal legislation on federal incorporation, *see generally* Reuschlein, *Federalization—Design for Corporate Reform in a National Economy*, 91 U. Pa. L. Rev. 91 (1942); Brown, *Federal Legislation: The Federal Corporation Licensing Bill: Corporate Regulation*, 27 Geo. L.J. 1092 (1939).

76. *Hearings on S. 10 before the Subcomm. of the Senate Comm. on the Judiciary*, 75th Cong., 1st Sess. 270–71 (1937).

77. *Id.* at 553. Senator O'Mahoney rephrased this argument by stating that "if a corporation is engaged in interstate commerce . . . it [should] come to the representatives of the people of the United States for a definition of its power." *Id.* at 441.

78. *See id.* at 444–45, 548–49.

Moreover, the bill would have required that a corporation's principal place of business be located in its state of incorporation (thereby presumably dooming the Delaware corporation), required shareholder reports, prescribed voting rights, mandated that shareholders approve officers' compensation, required that a court evaluate and approve the issuance of stock for services or property, and established, as a counterweight to management, "a certified corporation representative," an independent shareholders' representative to whom proxies could be tendered.⁷⁹

The remarkable thing about the O'Mahoney proposal and its predecessors, and about the recommendations of the TNEC, the SEC, and the Roper and Dickerson Commissions, is that nothing came of any of them. Out of the New Deal arose the modern superstructure of federal bureaus, agencies, and administrations. It was from the New Deal that the federal government emerged as the primary and paramount regulator of American economic life. The New Deal, however, did not bring basic corporation law under federal control.

Congress certainly had the power to enact federal corporation law. It was felt that a single federal law could bring uniformity to the corporate area. There was neither an explicit decision not to federalize corporation law, nor a specific reason given for the failure to reach a decision. One can deduce, however, why Congress was reluctant to venture into corporate law. In 1936, Professor Harris Berlack, with the advice of Felix Frankfurter and SEC General Counsel John J. Burns, argued against adoption of the original O'Mahoney Bill (S. 3363). Berlack agreed that federal control of corporation law was intended "gradually to impose the conditions necessary to subject corporate enterprise to the service of society as a whole."⁸⁰ Nonetheless, he observed that:

[E]ffective subjection of the corporate system of economic development to the interests of society as a whole is a major problem of modern social organization; that to vest the unlimited control of this system in the central government of the nation involves dangers perhaps greater than those sought to be avoided; that other effective means to accomplish the desired end should and doubtless can be devised.⁸¹

The debate over federal corporation law ends with congressional silence. All that can be stated with certainty is that Congress chose not to act. This was due at least partly to the political risks inherent in the centralization of economic power—Orwellian dangers which found ample illustration in the decade following 1936, and which should not be dismissed even today.

Another reason is congressional satisfaction with the balance that had been struck. With the 1933 and 1934 Securities Acts in place, the federal government had assumed a carefully circumscribed responsibility for regulation of the secondary trading market in securities—an area of the law effectively beyond the control of any one state.⁸² By contrast, in the area of basic corporation law, state law was

79. See generally Brown, *supra* note 75, for a full discussion of each of these points.

80. Berlack, *Federal Incorporation and Securities Regulation*, 49 Harv. L. Rev. 396, 424 (1936).

81. *Id.* at 425.

82. The Securities Exchange Act of 1934 is the broadest federal statute in the area; it must effectively be read as

established, sophisticated, and functioning. Thus, there was no need to supplant it.⁸³ The Supreme Court returned to these issues in the late 1970s.

B. Reaffirmation in the 1970s

It is still elemental law that a corporation is a creature of the state, with its powers determined and the rights of its participants defined by state law. Moreover, in recent years the Supreme Court has raised this point to the status of a deliberate conclusion. It has chosen not to federalize business law because of these factors.

In the 1960s and 1970s, a federalization of corporate law again seemed imminent. Rule 10b-5,⁸⁴ the anti-fraud rule promulgated under the Securities Exchange Act of 1934, had been expanded far beyond its original application to face-to-face securities transactions.⁸⁵ It was anticipated that Rule 10b-5 might be applied to business combinations, sales of control, "going-private" transactions, transactions structured to retain control, appropriations of corporate opportunities, self-dealing, derivative suits, and simple breach of fiduciary obligations.⁸⁶ Much of this speculation had been curtailed by the Supreme Court's decision in *Blue Chip Stamps Co. v. Manor Drug Stores*,⁸⁷ which required that a 10b-5 plaintiff be a purchaser or seller of securities, but it once again appeared that corporate regulation would soon become a federal concern.

In *Cort v. Ash*,⁸⁸ the Supreme Court refused to imply a private, federal cause of action for violations of a federal statute prohibiting corporations from spending money on presidential campaigns. The Court held that relief could properly be sought under the laws of Delaware, which had chartered the corporation in question. The Court suggested that the plaintiffs might proceed either through an *ultra vires* action, or an action for breach of the directors' fiduciary responsibilities. The Court explained:

federal quasi-corporate law. Even this must be read as limited, however, by Section 28(a) of the Act, with its intention to preserve state authority. See *supra* text accompanying notes 69-71.

83. It may not go too far to suggest that Congress was motivated by the same rationale which led the Supreme Court to renounce the policy of creating a federal common law. The essence of *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), is that federal law should govern areas of federal concern and state law govern areas of state concern. In the 1930s there was no need, and there is currently no need, to develop a federal law for corporations. Besides the problem of drafting such legislation, there would be problems with enforcement and interstitial law-making not seen since the days before *Erie*, when the federal and state rules coexisted in anything but harmony. Compare, e.g., *Old Dominion Copper Mining and Smelting Co. v. Lewisohn*, 210 U.S. 206 (1908), with *Old Dominion Copper Mining and Smelting Co. v. Bigelow*, 203 Mass. 159, 89 N.E. 193 (1909), *aff'd* 225 U.S. 111 (1912).

84. 17 C.F.R. § 240.10b-5 (1986).

85. Rule 10b (5) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(1) To employ any device, scheme, or artifice to defraud,

(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. §240.10b-5 (1986). See also *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied*, 404 U.S. 1005 (1971); *Superintendent of Ins. of New York v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971).

86. See Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 Bus. Law. 883 (1976).

87. 421 U.S. 723 (1975).

88. 422 U.S. 66 (1975).

“Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.”⁸⁹

Two years later, in *Piper v. Chris-Craft Industries, Inc.*,⁹⁰ the Court again restrained the impetus to federalize. In *Chris-Craft*, the Court was asked by a frustrated tender offer bidder to imply a cause of action under the Williams Act.⁹¹ After finding that the legislative history of the Williams Act evinced a congressional intent to provide remedies only for shareholders of the target corporation, the Court looked to *Cort v. Ash* for confirmation of this outcome.⁹² Working through the analysis of the earlier case, it held that implying a federal cause of action is disfavored when “the cause of action is one traditionally relegated to state law.”⁹³

The Court repeated this stand in *Santa Fe Industries v. Green*.⁹⁴ In *Santa Fe*, the minority shareholders of a Delaware corporation sought to enjoin a short-form merger intended to eliminate their interest in the firm. Alleging that the defendant majority shareholders had deliberately misappraised the value of their stock, the plaintiffs alleged that this was a “device, scheme, or artifice to defraud,” and therefore a violation of Rule 10b-5.⁹⁵

The Supreme Court rejected this argument, again upholding the state’s jurisdiction over intracorporate affairs. The opinion gave two main grounds for the decision—the fact that there had been no deception, and the danger of allowing Rule 10b-5 to become a universal solvent in the corporate area.

The Court, referring to its holdings in *Cort v. Ash* and *Chris-Craft*, found that there was indeed a state-law remedy available: “The Delaware Legislature has supplied minority shareholders with a cause of action in the Delaware Court of Chancery to recover the fair value of shares allegedly undervalued in a short-form merger.”⁹⁶ The opinion concluded with an unusual admonitory tone:

Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation would be overridden. As the Court stated in *Cort v. Ash*:

“Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law *expressly* requires certain responsibilities of directors with respect to stockholders, state law will govern. . . .”

We thus adhere to the position that “Congress by Sec. 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement. . . .” There may well be a need for uniform federal fiduciary standards to govern mergers. . . . But

89. *Id.* at 84.

90. 430 U.S. 1 (1977).

91. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982).

92. *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 40 (1977), citing *Cort v. Ash*, 422 U.S. 66, 78 (1975).

93. 430 U.S. 1 (1977), citing *Cort v. Ash*, 422 U.S. 66, 78 (1975).

94. 430 U.S. 462 (1977).

95. *Id.* at 467.

96. *Id.* at 478.

those standards should not be supplied by judicial extension of Sec. 10(b) and Rule 10b-5 to "cover the corporate universe."⁹⁷

The clear teaching of this trio of cases—*Cort v. Ash*, *Chris-Craft*, and *Santa Fe*—is that state law governs in the corporate area. Federal law forms an overlay, significant but secondary, upon state law. It does not provide for business organization, nor does it define or create trusts, partnerships, or corporations. It deals only with the transfer of interests in those business entities. The states create business organizations and define the interests which comprise them. Accordingly, state law controls. Unless the intent of Congress is clear—unless federal law expressly controls—state law should not be displaced.

IV. THE CURRENT DEBATE ON CORPORATE TAKEOVERS

The most recent assault on the states' authority to regulate corporations has been subtle and indirect. In the 1970s and 1980s, the most prominent means of business acquisition has been the tender offer—the purchase, through an offer to shareholders in a target corporation, of a controlling interest in the firm. At the same time lawyers and investment bankers were perfecting the tactics of takeover contests, academic lawyers developed a theory to explain—perhaps to rationalize—why corporate takeovers occurred. This theory argues that the easier it is for takeovers to succeed, the better for shareholders of the target companies, and for the economy as a whole. Accordingly, any factor which inhibits takeovers is bad for shareholders and for the economy.

This theory "is based on a model which characterizes swift and secretive corporate takeovers" as the means for appropriating the returns to certain kinds of investments.⁹⁸ The most important factors are resistance by target management, federal regulation under the Williams Act, and state laws which deal with changes in corporate control. Management resistance, the subject of the most vociferous law review polemics, has been generously shielded by the business judgment rule, and criticism of the Williams Act has been more discreet than valorous. State laws, however, have been caught in the crossfire. Because tender offers are carried out on a national level, it is claimed that state laws which regulate intracorporate relationships, if they affect a bidding firm's tender offer, are invalid under the Commerce Clause.

During the Progressive Era and the New Deal, the scholars and politicians who advocated establishing a uniform, national corporation law sought to do so through positive action—the enactment of a federal corporation law.⁹⁹ Those who currently call for uniform, national corporation laws would achieve their end by prohibiting state regulation.¹⁰⁰ The terminology has changed, but the issue is identical: Do the

97. *Id.* at 479–80 (citation omitted) (emphasis in original).

98. Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J. L. & Econ. 371, 373 (1980).

99. See *supra* text accompanying notes 68–83.

100. See, e.g., REPORT OF SEC ADVISORY COMMITTEE ON TENDER OFFERS, SEPARATE STATEMENT OF FRANK H. EASTERBROOK AND GREGG A. JARRELL 15 (1983). Easterbrook and Jarrell believe that "Congress should repeal the Williams Act and terminate all federal regulation of tender offers with a single exception[:] . . . preserve the rule of *Edgar v. MITE Corp.*,

states have any role to play in regulating corporations? If a corporation is engaged in interstate commerce, does it transcend state authority? Once a corporation has been created, may its officers and shareholders ignore the limits of the powers granted them by state corporation law and their corporate charter?

Takeover theorists, drawing upon financial models and analysis, have focused narrowly upon stock-market prices.¹⁰¹ In their concern with maximizing the value of shares, the theorists have ignored the issues of *what* shares are, and *why* and *how* they come into being. Discussions of takeover theory have overlooked the fact that state law lays the ground rules for corporations, that a corporation exists solely because a state has chartered it, that shares have value because state law defines and enforces the rights they represent—in short, the fact that a corporation is a creature of the state.

To the extent recognition of these issues surfaces, it appears mislabeled and diluted as the “internal affairs doctrine,” a choice-of-law rule that the law of only one state should govern the workings of a corporation. Omission of these issues has seriously flawed the debate over the legitimacy of state laws affecting takeovers. Without a consideration of these issues, the arguments made have often been materially misleading.

A. Takeover Theory in a Nutshell

The academic lawyers who have argued in favor of the corporate takeover, many of them associated with the University of Chicago,¹⁰² have hailed it as a device for policing the behavior of corporate managers.¹⁰³ This perspective focuses on the value of securities in the trading market. The theory postulates that there is no such thing as an “undervalued” stock because the market is perfectly efficient at pricing securities.¹⁰⁴ If a firm’s shares are selling for less than they might be worth, the firm’s

102 S. Ct. 2629 (1982), that state prohibitory regulation of tender offers is not lawful to the extent it affects interstate securities transactions.” *Id.*

101. Most articles in this field give the impression that a corporation is only a network of contracts, similar to an investment fund. Virtually no writer observes that corporations actually carry on business—that they manufacture automobiles, sell bolts of cloth, employ workers, or develop new products. To the extent this recognition does appear, it is reified into a concept of “moving assets to their highest-valued uses.”

102. Perhaps the most prominent have been Frank Easterbrook (formerly on the University of Chicago faculty of law, currently on the federal bench) and D.R. Fischel (formerly on Northwestern University’s faculty of law, now at the University of Chicago). See, *inter alia*, Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978); Easterbrook & Fischel, *The Proper Role of a Target’s Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Easterbrook & Fischel, *Takeover Bids, Defensive Tactics, and Shareholders’ Welfare*, 36 BUS. LAW. 1733 (1981); Easterbrook & Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN. L. REV. 1 (1982); Easterbrook & Jarrell, *Do Targets Gain From Defeating Tender Offers?*, 59 N.Y.U.L. REV. 277 (1984); Easterbrook & Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89 (1985); Easterbrook, *Manager’s Discretion and Investors’ Welfare: Theories and Evidence*, 9 DEL. J. CORP. L. 540 (1984); Easterbrook & Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271 (1986). See also Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J. L. & Econ. 371 (1980); Jarrell, *The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge?*, 28 J. L. & Econ. 151 (1985); Gilson, *Seeking Competitive Bids versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51 (1982); Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981).

103. See, e.g., Easterbrook & Fischel, *The Proper Role of a Target’s Management in Responding to a Tender Offer*, *supra* note 102, at 1173–74.

104. See generally Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978). “[A]ll information about a company’s securities is reflected in their

present management is inefficient and the paramount role of corporate management is to keep share prices high. To police management ineptitude, the hostile takeover is the best remedy.

Because the hostile takeover is effective at keeping share prices high, this view concludes that any factor which hinders takeovers is bad for the economy. Management resistance and takeover regulation make tender offers more difficult to conclude; therefore they harm target shareholders—and the economy at large, because this reduces the level of market monitoring being done. Even if such hindrances ultimately bring a higher price to target shareholders—because other bidders appear in the cooling-off period set by government regulation, or management resists by bringing in a friendly company with a higher bid—the effect is undesirable because such contests may discourage other bidders from making offers for other corporations. Corporate raiders should be favorites of the law and should be able to take over as many corporations as possible for the lowest possible price.

A corollary emerges: If a corporation is taken over, it deserved to be. If a tender offer is made, it is because share prices were low. If share prices were low, it is because management was inefficient. The market is never wrong, and if a takeover occurs, it is for the best.¹⁰⁵

The principal merit of this model is its ease of operation. It explains very complex phenomena, methodically and completely, using a few simple concepts. One must recall, however, that it is an economic theory. A theory is a mechanism offered to explain a phenomenon witnessed in the real world. It is valid to the extent that it is based upon and accounts for all relevant data. If it relies upon irrelevant information, or if other explanations account for more facts, its usefulness has ended. It then ceases to be a theory and becomes a creed, an expression of faith. Unfortunately for this takeover model, it seems to have become a creed.¹⁰⁶ Unfortunately for American law, its validity has too often been assumed.

Many assumptions of this model have been undermined or overturned. Professor Louis Lowenstein examined the model's two crucial postulates (that the market is always completely efficient at pricing all shares, and that the stock market's pricing of shares accurately reflects the value of the corporations which issued those shares) and found them extremely questionable. Because of market imperfections and

price, making the prices of securities the best available indicators of their value. As such, 'prices are accurate signals for capital allocation.'" *Id.* at 5.

105. To the observation that many target companies had certainly seemed well-run and profitable, Easterbrook and Fischel reply in true Chicago style:

These observations are invoked to support an assertion that the acquired firms were not doing poorly; consequently, the argument concludes, tender offers do not move assets to better managers.

This is unpersuasive. It amounts to second-guessing the market. . . . The highly subjective observation that acquired firms are well run does not exclude the possibility that, in new hands, the firms would be better run. Only proof that markets are not efficient in pricing shares could support the argument that tender offers do not improve the use of resources.

Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1182-83 (1981).

106. "In Chicago-babble, 'must be' is the preferred verb form." Kuttner, *The Truth About Corporate Raiders*, *The New Republic* 14, 17 (Jan. 20, 1986).

fundamental differences between the pricing of stock and the pricing of companies, Lowenstein concluded that even well-run, profitable firms can become vulnerable to takeovers.¹⁰⁷

The alleged "efficiency" of the corporate raider versus the "inefficiency" of the target was effectively challenged by Professors Robert H. Hayes and David A. Garvin.¹⁰⁸ Hayes and Garvin demonstrated that "efficiency" is really a question of short-term, not long-term, planning. Firms which are investing in capital stock and research and development appear to be less profitable than firms which speculate by making outside investments and paying out dividends. Thus, the company which is planning for the long term fits the description of an "inefficient" target, one whose management a corporate raider should be called in to "improve."¹⁰⁹

The statistical evidence, finally, does not support the contention that the purported obstacles are as formidable as claimed. "To describe the state tender offer laws as 'antitakeover' statutes is not accurate by our evidence, although the laws do marginally reduce the number of cash takeovers," concluded the most detailed study.¹¹⁰ The flaws of this model had only begun to surface, however, at the time the United States Supreme Court decided *Edgar v. MITE Corp.*¹¹¹ in 1982.

B. The Murky Standard of *Edgar v. MITE Corp.*

MITE involved a cash tender offer by MITE Corporation, a Delaware corporation, for all the outstanding shares of Chicago Rivet and Machine Company, an

107. Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 306 (1983).

Applying price-earnings ratio studies, which were more sophisticated than the market reaction studies relied upon by the Chicago School, Lowenstein found evidence confirming "the old suspicion that buyers tend to congregate excessively around those stocks that are then in favor and to neglect too much those that are not . . . [that is], that the market fails to respond promptly and in an unbiased fashion to price earnings ratio information." *Id.* at 284. *See id.* at 283-87 for a summary of the studies.

But even if stock markets were demonstrably efficient at pricing shares for trading, "the market is efficient only at what it seeks to do, and its efficiency in pricing for traders and institutional investors is only loosely related to its efficiency in pricing for the buyer willing to purchase the enterprise as a whole. . . . [T]he pricing patterns are such as to produce, in almost any period, a number of attractively priced takeover candidates." *Id.* at 274. The result is that some out-of-favor companies "may have so dropped in price that they become takeover targets regardless of the quality of their management of their prospects." *Id.* at 284.

108. Hayes & Garvin, *Managing As If Tomorrow Mattered*, 60 HARV. BUS. REV. 71 (May-June 1982).

109. Hayes and Garvin concluded that a corporation can invest its profits in two ways—to maintain its earnings-generating capacity (through modernization and R & D), or by speculating in outside investment, "either directly or indirectly via dividends to shareholders." *Id.* at 74. Present-value calculation, the system of financial analysis now prevalent in American business, makes the second alternative more valuable on paper. Corporate officers are thus tempted to reduce their capital budgets in order to have more money for outside investments. "[P]resent-value calculations support a decision to operate on the goose and remove some of its golden eggs prematurely, even though doing so impairs its future egg-laying ability. In fact, such calculations always justify a policy of progressive disinvestment as long as a company's net return on internal investment . . . is less than its net return from external investment. . . ." *Id.* at 74-75. Over the long run, although firms may show higher profits, their physical capital deteriorates and they become less and less able to compete.

110. Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J. L. & ECON. 371, 401-02 (1980). The major hindrance to tender offers is the Williams Act and there are often muted calls for its repeal. *See* Fischel, *supra* note 104, at 26; Smiley, *The Economic Effect of the Williams Amendment*, 31 INDUS. ORG. REV. 138 (1975).

111. 457 U.S. 624 (1982).

Illinois corporation. The Illinois Business Takeover Act¹¹² posed substantial hurdles to MITE's bid. It allowed the Illinois Secretary of State to deny registration to a tender offer, effectively blocking the bid, if he determined that the bid was unfair. Covered under the Act were all corporations in which Illinois shareholders owned ten percent of any class of equity securities, or any corporation which met two of the following three criteria: having its principal executive offices in Illinois, being organized under Illinois law, or having at least ten percent of its physical capital and paid-in surplus within Illinois.¹¹³ Although MITE complied with the filing requirements of the Williams Act, it did not comply with the state takeover law, suing instead for a declaratory judgment that the Illinois statute was preempted by the Williams Act and violated the Commerce Clause.

The Supreme Court's decision in *MITE* was one of those decisions which can be characterized as a hydra-headed monster. There were five major parts, three concurrences, and two separate dissents. In the final analysis, a bare majority of the Court held that the Illinois statute was unconstitutional as an indirect burden on interstate commerce.¹¹⁴ No record evidence supported this conclusion.¹¹⁵ The Court, however, cited arguments common in takeover theory:

The Illinois Act is . . . unconstitutional under the test of *Pike v. Bruce Church, Inc.*, . . . for even when a state statute regulates interstate commerce indirectly, the burden imposed on that commerce must not be excessive in relation to the local interests served by the statute. The most obvious burden the Illinois Act imposes on interstate commerce arises from the statute's previously described nationwide reach which purports to give Illinois the power to determine whether a tender offer may proceed anywhere.

The effects of allowing the Illinois Secretary of State to block a nationwide tender offer are substantial. Shareholders are deprived of the opportunity to sell their shares at a premium. The reallocation of economic resources to their highest valued use, a process which can improve efficiency and competition, is hindered. The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced.¹¹⁶

112. Public Act 80-1421, 1978 Ill. Laws 1581, *repealed by* Act of Sept. 14, 1983, Public Act 83-365, 1983 Ill. Legis. Serv. 2628.

113. 457 U.S. 624, 627 (1982).

114. A head count is essential to understanding the tentative nature of the holding:

Part I: Statement of Facts. (Six Justices agreed on this: White, Burger, Blackmun, Powell, Stevens, and O'Connor.)

Part II: The Case is not moot. (Five Justices: White, Burger, Blackmun, Stevens, and O'Connor.)

Parts III and IV: The Illinois law is preempted by the Williams Act. (Three Justices: White, Burger, and Blackmun.)

Part V-A: The Illinois law is an unconstitutional direct burden on interstate commerce. (Four Justices: White, Burger, Stevens, and O'Connor.)

Part V-B: The Illinois law is an unconstitutional indirect burden on commerce. (Five Justices: White, Burger, Stevens, O'Connor, and Powell). *Id.* at 626, asterisked note.

Justices Marshall and Brennan felt that the case was moot. Justice Rehnquist felt that the case was moot, but for different reasons. Justice Powell also felt that the case was moot, but concurred in Part V-B "in view of the decision of a majority of the Court to reach the merits." *Id.* at 648.

Only Parts I, II, and V-B were denominated as the opinion of the Court. *Id.* at 626.

115. The Seventh Circuit had stated, "Turning again to the Illinois Act, any conclusion as to the actual effect it has had, or may have, on tender offers in Illinois would be purely speculative because the record is devoid of evidence on that subject." *MITE Corp. v. Dixon*, 633 F.2d 486, 497 (7th Cir. 1980).

116. *Edgar v. MITE Corp.*, 457 U.S. 624, 643 (1982) (citations to Easterbrook and Fischel omitted).

The Court minimized the local interests which Illinois asserted were protected by the statute—investor protection and the regulation of corporate internal affairs. “While protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders.”¹¹⁷ The Court also noted that “the Act . . . applies to corporations that are not incorporated in Illinois and have their principal place of business in other States. Illinois has no interest in regulating the internal affairs of foreign corporations.”¹¹⁸

It is important to note how takeover theory influenced this opinion. It clearly furnished the idea that tender offers benefit the national economy and that anything that inhibited them was thus a burden on interstate commerce. Less obviously, takeover theory also set the terms of the debate. The opinion’s focus on share prices presented the corporation as an investment pool rather than a business enterprise. There was no consideration of why shares exist; their existence, and the existence of the corporation which issued them, was assumed.

From this perspective it was logical to view investor protection in terms of where the shareholders live rather than by what authority they hold their rights. Even to say that one law *should* govern a corporation’s workings (which the internal affairs doctrine does) does not present the issue adequately. The point made in *Ashley v. Ryan* and *Louisville and Nashville R.R.*, and driven home in *Cort v. Ash* and *Santa Fe*—that the chartering state’s law *does* control—is to be considered and accepted as a given. It is not a shareholder’s address that determines whether his or her rights are affected by a state’s corporation law. It is the fact that he or she holds rights created by the state when it chartered the corporation.

Takeover theory was also influential in the Court’s conclusion that tender offers do not involve a corporation’s internal affairs. Once again, the theory’s focus on secondary market trading presented the tender offer as simply a scaled-up version of an ordinary securities transaction, rather than a corporate control transaction like a merger or sale of assets, which it resembles from a different viewpoint.

Even though five Justices ruled the Illinois law unconstitutional, *MITE* was not as hard as it seemed on state takeover regulation. The majority opinion included Justice Powell, who suggested that “Commerce Clause reasoning leaves some room for state regulation of tender offers.”¹¹⁹ Justice Stevens, also a member of the majority, felt that states retained some latitude in regulating tender offers. “I am not persuaded,” he concluded, “that Congress’ decision to follow a policy of neutrality in [the Williams Act] is tantamount to a federal prohibition against state legislation designed to provide special protection for incumbent management.”¹²⁰

The holding of *MITE* was splintered and difficult, but one result was certain and immediate. The Illinois Business Takeover Act was unconstitutional, and with its fall all state takeover legislation came under suspicion.

117. *Id.* at 644.

118. *Id.* at 645–46.

119. *Id.* at 646 (Powell, J., concurring).

120. *Id.* at 655 (Stevens, J., concurring).

C. State Responses to MITE

Following *MITE*, state regulation of tender offers began from a different perspective, one which treated the takeover bid as an "attempt to secure a fundamental change in [a] corporation [through a series of security transactions with [its shareholders]]."¹²¹

The tender offer resembles two legal paradigms: the corporate control transaction (the merger, the sale of assets, the proxy fight, or the consolidation) and the ordinary sale of stock. The very scale of a tender offer, however, shows its dissimilarity to the ordinary scale. So does the fact that a tender offer is made to acquire control of the corporation which issued the share.

Viewed in a purely functional sense, the tender offer is indistinguishable from other control transactions. It is a de facto proxy solicitation in which the bidder seeks to gain a controlling block of votes.¹²² Shareholders who tender, and are paid the premium, are placed in the same position they would have been after a merger.¹²³ Tender offers, like other control transactions, are usually the first step toward a change in corporate policies. In terms of mechanisms and duties, the resemblances between the tender offer and other control transactions are also suggestive:

Bids are by definition made by an incipient controlling person who under traditional common law doctrines will acquire, upon successful completion of the bid, a fiduciary relationship to the corporation and all of its securityholders. . . . Furthermore, the offeror is acquiring his controlling block from a group of securityholders acting in concert through the unifying mechanism of a tender offer. If control is a corporate asset, corporate property is being transferred.¹²⁴

In some ways, the tender offer subjects shareholders to greater perils and uncertainties than other control transactions. The hostile tender offer gives the individual shareholder no real choice but to tender his shares. There has been no prior consultation with the evaluation of the offer by the target firm's board of directors, the shareholder has no independent evaluation of the bid's merit, and he has no way of knowing what other shareholders plan to do. Left in the dark, the shareholder must tender because he cannot afford the risk of being locked into the acquired firm, with no market for his securities.¹²⁵

These factors compel the conclusion that the tender offer is a corporate control transaction of the type traditionally regulated by the states.¹²⁶ It hardly matters that

121. Sargent, *On the Validity of State Takeover Regulation: State Responses to MITE and Kidwell*, 42 OHIO ST. L.J. 689, 724 (1981).

122. See H.R. REP. NO. 1711, 90th Cong., 2d Sess. (1968).

123. *AMCA Int'l Corp. v. Krouse*, 482 F. Supp. 929, 939 (S.D. Ohio 1979).

124. Shipman, *Some Thoughts About the Role of State Takeover Legislation: The Ohio Takeover Act*, 21 CASE W. RES. L. REV. 722, 724 (1970).

125. See Lowenstein, *supra* note 107, at 307; Jensen & Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5, 31-32 (1983); see also *L. P. Acquisitions Co. v. Tyson*, 772 F.2d 201, 207 (6th Cir. 1985), (citing Justice Powell's *MITE* concurrence). Tactics like the two-tier front-loaded offer only aggravate the problem.

126. See Shipman, *supra* note 124; McCauliff, *Federalism and the Constitutionality of State Takeover Statutes*, 67 VA. L. REV. 295 (1981); Boehm, *State Interests and Interstate Commerce: A Look at the Theoretical Underpinnings of Takeover Legislation*, 36 WASH. & LEE L. REV. 733, 742 (1979); Note, *Securities Law and the Constitution: State Tender Offer Statutes Reconsidered*, 88 YALE L.J. 510 (1979); Note, *The Constitutionality of State Takeover Statutes: A Response*

it represents a more recent development than the merger or consolidation; its effects are the same and its potential for abuse is at least as great. Following *MITE*, many of the states which moved to regulate takeovers, or to revise their existing statutes to conform with *MITE*, began from this perspective. The Illinois Business Takeover Act¹²⁷ was not atypical of earlier legislation, which often applied to firms only tangentially related to the state, and often allowed a state official to block a tender offer outright.¹²⁸ The second generation of takeover statutes treated tender offers as corporate control transactions and approached the question as one of corporation law.¹²⁹

The Ohio Control Share Acquisition Act¹³⁰ was the first statute passed in response to *MITE*. It formed the basis, partially or entirely, for the takeover statutes passed since 1982 by legislatures in Hawaii, Indiana, Minnesota, Missouri, and Wisconsin.¹³¹ The Ohio statute and its progeny regulate the first stage of a tender offer by regulating "control share acquisitions." This approach subjected acquisitions of certain magnitudes to approval by a vote of disinterested shareholders. Another approach was taken by a second group of states—led by Maryland, and including Connecticut, Georgia, Kentucky, Michigan, Mississippi, Virginia, and Wisconsin. These states regulate the second stage of corporate takeovers—events following the completion of a tender offer.¹³² Pennsylvania, followed by Maine, has

to Great Western, 53 N.Y.U. L. REV. 872, 931–34 (1978); but see Langevoort, *State Tender Offer Legislation: Interests, Effects, and Political Competency*, 62 CORNELL L. REV. 213 (1977); Note, *State Takeover Statutes Versus Congressional Intent: Preempting the Maze*, 5 HOFSTRA L. REV. 857 (1977); Wilner & Landy, *The Tender Trap: State Takeover Statutes and Their Constitutionality*, 45 FORDHAM L. REV. 1 (1976); Note, *Commerce Clause Limitations upon State Regulation of Tender Offers*, 47 S. CALIF. L. REV. 1133 (1974). The tender offer's identity as a corporate control transaction is also discussed in several of the articles dealing with post-*MITE* takeover laws. See *infra* notes 130–31 and accompanying text.

127. ILL. REV. STAT. ch. 121 1/2, § 137.51 *et seq.* (1979).

128. A useful survey of pre-*MITE* state takeover laws is given in Ryndal, *State Takeover Statutes Under Attack—Casualties in the Battle for Corporate Control—MITE Corp. v. Dixon*, 30 DEPAUL L. REV. 989 (1981). See also Profusek & Gompf, *State Takeover Regulation After MITE: Standing Pat, Blue Sky, or Corporation Law Concepts?*, 7 CORP. L. REV. 3, 4–15 (1984).

129. A critical survey of the succeeding generation of state takeover is found in Pinto, *Takeover Statutes: The Dormant Commerce Clause and State Corporation Law*, 47 U. MIAMI L. REV. 473 (1987). See also Note, *Can State Tender-Offer Regulation Be Made Constitutional?*, 20 Hous. L. REV. 1475 (1983); Kreider, *Fortress Without Foundation? Ohio Takeover Act II*, 52 U. CIN. L. REV. 108 (1983); Note, *State Insurance Takeover Acts: A Constitutional Analysis After Edgar v. MITE*, 59 IND. L.J. 255 (1984); Profusek & Gompf, *State Takeover Legislation After MITE: Standing Pat, Blue Sky, or Corporation Law Concepts?*, 7 CORP. L. REV. 3 (1984); Wolff, *Toward A Constitutional State Tender Offer Statute*, 7 U. ARK. LITTLE ROCK L.J. 83 (1984); Sell, *A Critical Analysis of a New Approach to State Takeover Legislation After MITE*, 23 WASHBURN L.J. 473 (1984); Note, *Second Generation State Takeover Legislation: Maryland Takes a New Tack*, 83 MICH. L. REV. 433 (1984); Note, *Minnesota's Corporate Take-Over Act—"Still" Unconstitutional?*, 8 HAMLINE L. REV. 255 (1985); Note, *Has Ohio Avoided the Wake of MITE?—An Analysis of the Constitutionality of the Ohio Control Share Acquisition Act*, 46 OHIO ST. L.J. 203 (1985); Note, *The Tender Offer Regulation Battle Continues: Should States Regulate Only Local Companies?*, 60 IND. L.J. 721 (1985); Steinberg, *Do The Second-Generation State Takeover Statutes Violate the Commerce Clause?*, 8 CORP. L. REV. 3 (1985); Block, Barton & Roth, *State Takeover Statutes: The "Second Generation,"* 13 SEC. REG. L.J. 332 (1986).

130. OHIO REV. CODE ANN. § 1701.831 (Page 1983).

131. 1984 MO. ANN. STAT. § 351.407 (Vernon Supp. 1986); MINN. STAT. ANN. § 302A.671 (West Supp. 1986); HAW. REV. STAT. § 416–171 to 172 (Supp. 1985); IND. CODE ANN. 23–1–42–1 to –42–11. (Burns Supp. 1986). The Wisconsin legislation combines both the Ohio and the Maryland approaches. See also Note, *Minnesota's Corporate Take-Over Act: "Still" Unconstitutional?*, *supra* note 129; Comment, *The Constitutionality of Minnesota's New Corporate Takeover Act: The Cardiff Failure*, 11 WM. MITCHELL L. REV. 853 (1985).

132. The Maryland statute, for example, gives particular protection to nontendering shareholders by requiring supermajority approval of subsequent business combinations, or, in the alternative, a fair-price cash-out. MD. CORPS. & ASS'NS CODE ANN. § 3–601–3 (1985 Repl. Vol.); see also CONN. GEN. STAT. ANN. §§ 33–374a to 374c (West Supp. 1986);

coupled this latter approach with an apparent endorsement of resistance by a target corporation's management.¹³³ A fourth approach is that of New York, which also regulates the second stage of a corporate takeover. New York prohibits a raider from effecting a business combination with a New York corporation for five years unless the stock acquisition or combination is approved in advance.¹³⁴ Nebraska has voted to avoid questions of interstate commerce by regulating only tender offers made to Nebraska residents.¹³⁵

Among this second generation of state takeover laws, litigation has most frequently involved "control share acquisition" statutes—statutes modeled after Ohio's. Minnesota's takeover legislation survived two legal challenges in 1984.¹³⁶ In 1985, however, a federal district court ruled that the Minnesota Control Share Acquisition Statute¹³⁷ violated the Commerce Clause.¹³⁸ Because this decision was vacated by the Eighth Circuit Court of Appeals only three months later, the exact status of Minnesota's takeover legislation remains unsettled.¹³⁹

In 1985, the Missouri Control Share Acquisition Statute¹⁴⁰ was challenged by Carl Icahn during his successful tender offer for Trans World Airlines. A federal district court ruled that the Missouri statute, as applied to corporations not chartered in Missouri, was both preempted by the Williams Act and impermissible under the Commerce Clause.¹⁴¹ In 1986, a Commerce Clause rationale based on *MITE* (and a Supremacy Clause argument drawing on a questionable "*MITE* plurality" of three justices) was used by the Sixth and Seventh Circuits to invalidate the Ohio and Indiana statutes.¹⁴²

GA. CODE ANN. §§ 14-2-232-34 (1986 Cum. Supp.); KY. REV. STAT. ANN. §§ 271A.396-98 (Baldwin Supp. 1986); LA. REV. STAT. ANN. §§ 12:132-134 (West Supp. 1986); MICH. COMP. LAWS ANN. §§ 450.1775-1784 (West Supp. 1985) MISS. CODE ANN. §§ 79-25-1 to 25-7 (Supp. 1985); VA. CODE ANN. §§ 13.1-725-28 (1985 Repl. Vol.).

133. PA. STAT. ANN. tit. 15, § 1409.1 (Purdon Supp. 1986); ME. REV. STAT. ANN. tit. 13-A, § 901 (1985).

134. A person who acquires 20% of the voting equity in a New York corporation may not engage in a business combination with that firm for five years after the stock acquisition unless the target's board of directors approves the transaction in advance. Without this approval, even after the five-year period, any business combination must be approved by the disinterested shareholders or meet fair-price requirements. 1985 N.Y. LAWS ch. 915.

135. Corporate Takeover Act, NEB. REV. STAT. §§ 21-2418-2430 (1983). Oklahoma, after the Oklahoma Take-Over Bid Act, 71 OKLA. STAT. §§ 431-450, was struck down in *Mesa Petroleum Co. v. Cities Service Co.*, 715 F.2d 1425 (10th Cir. 1983), passed a new law, the Oklahoma Energy Resource Conservation Act, 1985 OKLA. SESS. LAWS CH. 2 (to be codified at 52 OKLA. SESS. LAWS §601 *et seq.* (1985)). This act, giving the Oklahoma Corporation Commission the power to block tender offers for energy resource companies, was held unconstitutional in *Mesa Partners II v. Unocal Corp.*, 607 F. Supp. 624 (W.D. Okla. 1985).

136. *Cardiff Acquisitions, Inc. v. Hatch*, 751 F.2d 906 (8th Cir. 1984); *Edudata Corp. v. Scientific Computers Inc.*, 746 F.2d 429 (8th Cir. 1984).

137. MINN. STAT. §§302A.011(37)-(40), 302A.449 (7), 302A.671 (West Supp. 1986).

138. *APL Ltd. Partnership v. Van Dusen Air, Inc.*, 622 F. Supp. 1216 (D. Minn. 1985), *vacated*, Case Nos. 85-5285 & 85-5286 (8th Cir. Nov. 26, 1985). In November 1986, the same district court again held a revised version of the Minnesota statute unconstitutional. The Commerce Clause again provided the main rationale for the decision, with the Supremacy Clause cited as an alternative. *Gelco Corporation v. Coniston Partners*, 18 SEC. REG & L. REP. (BNA) 1783 (Dec. 12, 1986).

139. See Note, *Minnesota's Corporate Take-Over Act: "Still" Unconstitutional?*, 8 HAMLINE L. REV. 255 (1985); Comment, *The Constitutionality of Minnesota's New Corporate Takeover Act: The Cardiff Failure*, 11 WM. MITCHELL L. REV. 853 (1985).

140. MO. ANN. STAT. §351.407 *et seq.* (Vernon Supp. 1986).

141. *Icahn v. Blunt*, 612 F. Supp. 1400 (W.D. Mo. 1985).

142. *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986), *cert. granted*, 107 S. Ct. 258 (1986); *Fleet Aerospace Corp. v. Holderman*, 796 F.2d 135, 139 (6th Cir. 1986).

Looking at the cases, one could conclude that control share acquisition statutes are impermissible. One could also press further and conclude that if the Ohio approach is unconstitutional, then the Maryland approach ought to withstand Commerce Clause scrutiny. Such conclusions, however, would be premature, unduly simplistic, and wrong. If we take seriously what *MITE* actually said, the Ohio statute (and probably the Indiana statute as well) should stand. For if the Ohio statute unduly burdens interstate commerce, it is virtually inconceivable that any state law having any impact on takeovers can stand. This includes not only laws which regulate the second stage of a takeover, but even traditional corporation law.

D. Deciphering *MITE*: The Case's Actual Holding

The fragmentation of *MITE* reduces to the following identifiable points: First, the case says very little about the Supremacy Clause—the argument that the Williams Act preempted the Illinois takeover law lost by a vote of six justices to three. Second, with regard to Commerce Clause analysis, *MITE*'s teaching is that state law must be even-handed, because state policy cannot be protectionist. State action must not directly interfere with interstate commerce and accordingly no state official may intervene. Finally, a state cannot regulate takeovers of corporations chartered by other states because this would probably discriminate against out-of-state interests.

It was impermissible for the Illinois Secretary of State to be able to block *MITE*'s bid. This would have halted the tender offer directly and absolutely and would have been a direct burden on interstate commerce. It was interference in a national tender offer by a local official which raised the suspicion of protectionism. In addition, the statute was so broad jurisdictionally that it would have allowed Illinois to intervene where it had no right to do so—in the internal affairs of foreign corporations. This both opened the way for and tended toward protectionism.

MITE clearly intends that the states be allowed some authority to regulate corporate control transactions—otherwise Justice Powell would not have concurred. It also suggests that such state regulation may be allowed to benefit target management more than it benefits corporate raiders—otherwise Justice Stevens would not have concurred. When one remembers that the *MITE* Court had to rely upon secondary materials which (1) exemplified advocacy scholarship, (2) overestimated the national interests in encouraging corporate takeovers, and (3) ignored the importance of the primary markets and the deleterious effects takeovers have had there, the conclusion becomes compelling: It is indeed constitutional for state regulation to affect tender offers.

State regulation must be limited in scope. It must be limited to corporations chartered by the state. It cannot prevent outright or block a tender offer and it must not give any local official the power to intervene in a tender offer. It cannot discriminate against out-of-state bidders. But within these bounds, state corporate law must be allowed to function even if it affects tender offers. This is because of the fundamental interests of the state in creating vehicles for capital formation and with

the rights of shareholders in these corporations. It is also because there is no federal corporation law to define the parties' rights and responsibilities. And if we do not draw the line here, there will be no state corporation law. The same analysis which concludes that all state takeover regulation is impermissible also argues that all state corporation law burdens interstate commerce to the same degree and should also be held impermissible.

V. A MIDWESTERN REIGN OF ERROR: *DYNAMICS* AND *FLEET AEROSPACE*

A. *The Indiana and Ohio Statutes*

Ohio and Indiana have approached control share acquisition by establishing thresholds of ownership within the corporations and requiring that any acquisition which would increase the size of a voting block beyond one of these levels be approved by a vote of disinterested shareholders.¹⁴³ These levels are set at 20% ownership, 33 1/3% ownership, and 50% ownership.¹⁴⁴ Thus, no non-shareholder can purchase 25% of a corporation without shareholder authorization; nor could an 18% holder purchase an additional 3%, or a 40% shareholder an additional 11%.

The jurisdiction of these laws has been carefully limited. Significantly, each state's law applies only to corporations chartered by that state.¹⁴⁵ Each law is also directed to a particular subset of those corporations with a significant business nexus with the chartering state. An Ohio "issuing public corporation" must have its principal place of business, principal executive offices, or substantial assets within the state.¹⁴⁶ An Indiana "issuing corporation," in addition to meeting the same criteria, must have more than ten percent of its shareholders resident in Indiana, more than ten percent of its stock owned by Indiana shareholders, or have more than 10,000 Indiana shareholders.

In either state, a person wishing to acquire a control interest must deliver an "Acquiring Person Statement" to the corporation's management for distribution to the shareholders.¹⁴⁷ Once this statement is delivered, the corporation has ten days

143. OHIO REV. CODE ANN. § 170.831 (Page 1983); IND. CODE ANN. § 23-1-42-1 *et seq.* (Burns Supp. 1986). A "control share acquisition" includes not only tender offers, but also open market purchases and privately negotiated block transactions. The term does not include transfers completed or agreed to prior to passage of the laws, by the law of descent or distribution, pursuant to a pledge or security interest, pursuant to a negotiated merger, or from persons whose acquisition was authorized or exempted, unless this would move a control block's size above one of the control block thresholds. OHIO REV. CODE ANN. § 1701 (Z)(2) (Page 1983); IND. CODE ANN. § 23-1-42-2 (d)-(e) (Burns Supp. 1986).

144. OHIO REV. CODE ANN. § 1701.01 (Z)(1)(a)-(c) (Page 1983).

145. OHIO REV. CODE ANN. § 1701.01(Y) (Page 1983) ("issuing public corporation" means a domestic corporation with fifty or more shareholders"); IND. CODE ANN. §§ 23-1-42-4 (Burns, Supp. 1986) ("issuing public corporation" means a corporation that has (1) one hundred (100) or more shareholders"), 23-1-20-5 ("Corporation" or "domestic corporation" means a corporation for profit that is not a foreign corporation, incorporated under or subject to the provisions of this article"). Corporations can opt out of the Acts' coverage. OHIO REV. CODE ANN. § 1701.831(A) (Page 1983); IND. CODE ANN. § 23-1-42-5 (Burns Supp. 1986).

146. OHIO REV. CODE ANN. 1701.01(Y) (Page 1983).

147. OHIO REV. CODE ANN. §§ 1701.01(BB), 1701.831(B), 1701.831(D) (Page 1983); IND. CODE ANN. §§ 23-1-42-6, 23-1-41-8 (Burns Supp. 1986). The statement must be accompanied by a statement by the corporation officers on their position concerning the acquisition.

In both states, the Acquiring Person Statement must identify the acquiring person, indicate that it is the Acquiring

within which to call a special shareholder's meeting to vote on the acquisition. Under both the Ohio and Indiana statutes, this meeting must be held within fifty days. It may not be held within thirty days of the delivery of the Acquiring Person Statement if the acquiring person so requests in writing when delivering the statement.¹⁴⁸ Thus, under either law, a person who wishes to purchase a control interest in a corporation will have the matter voted on within sixty days.

The vote that is taken on the proposed acquisition is a vote of disinterested shares. The Ohio statute requires that the acquisition be approved by both a majority of the shares present at the special meeting and by a majority of the disinterested shares—shares not controlled by the acquiring person or by the corporation's officers and inside directors.¹⁴⁹ The Indiana statute also requires acquisition approval by a majority of all shares and by a majority "excluding all interested shares."¹⁵⁰ If the shareholders approve, the acquisition can go forward. If they do not approve under the Ohio law, the acquisition simply cannot proceed. Under the Indiana statute, the shares which are transferred in an acquisition that is not approved lose their voting rights.¹⁵¹ Furthermore, these shares can be "redeemed" by the corporation "at the fair value thereof."¹⁵²

B. Dynamics and Fleet Aerospace: *The Cases and the Controversy*

The Ohio and Indiana Control Share Acquisition statutes are often in *pari materia* conceptually and literally. It is hardly surprising that the Sixth and Seventh Circuit Courts of Appeals, in recent opinions holding these laws unconstitutional, took exactly the same approach, the later opinion drawing upon the earlier. It is disappointing, however, that these conclusions were reached so reflexively, even light-heartedly, because the cases presented fresh issues and radically innovative legislation.¹⁵³

Person Statement, set forth the number of shares already controlled by the acquiring person, reveal into what voting range the acquisition would place the acquiring person, describe "in reasonable detail" the terms of the transaction, and give adequately supported representations that the transaction is not unlawful and is financially feasible for the acquiring person. OHIO REV. CODE ANN. §§ 1701.831(B)(1)–(6) (Page 1983); IND. CODE ANN. 23–1–42–6 (1)–(5) (Burns Supp. 1986).

148. OHIO REV CODE ANN. § 1701.831(C) (Page 1983); IND. CODE ANN. § 23–1–42–7 (Burns Supp. 1986). The Indiana Statute requires that the acquiring person request the special meeting and undertake to pay its expenses. Ohio's law is more generous, requiring that the meeting be called automatically following the delivery of the Acquiring Person Statement, not requiring the undertaking, and providing that the special meeting not be held later than any other special meeting. Both states allow the vote to be held later than sixty days, if the acquiring person so agrees in writing.

149. OHIO REV. CODE ANN. §§ 1701.831(E)(1), 1701.01(CC) (Page 1983). A quorum, similarly, requires a majority of both groups.

150. IND. CODE ANN. § 23–1–42–9 (Burns Supp. 1986). The Indiana statute is phrased in terms of "voting groups," which are defined by IND. CODE ANN. § 23–1–38–4(a) (Burns Supp. 1986) in terms of shareholders whose rights would be affected by exchanges, reclassifications, repriorizations, or alterations of rights—in short, those security holders whose rights would be changed by the ultimate outcome of the proposed acquisition. As in Ohio, shares which are "interested" are those controlled by the acquiring person, officers, or inside directors. *Id.* at § 23–1–42–3.

151. IND. CODE ANN. §§ 23–1–42–5, 23–1–42–9 (Burns Supp. 1986). Such acquired shares "have the same voting rights as were accorded the shares before the control share acquisition only to the extent granted by "the disinterested shareholders." *Id.* at § 23–1–42–9(a).

152. *Id.* at §§ 23–1–42–10. Possibly this favors target management too much, by giving them the power to extinguish a threat to their control.

153. The results can be attributed principally to the confusion engendered by *MITE*. The division among the Supreme Court Justices in that case has encouraged lower courts to follow a perceived *idee recui*, rather than close analysis. It may not be coincidental that the Seventh Circuit's opinion in *Dynamics Corp.* was written by Judge Richard

The opinions in question are *Dynamics Corp. of America v. CTS Corp.*,¹⁵⁴ in the Seventh Circuit, and *Fleet Aerospace v. Holderman*,¹⁵⁵ in the Sixth. In each case, a corporate bidder made a tender offer which, under applicable state law, required shareholder approval. Dynamics already owned 9.6% of CTS Corp. and its offer for another million shares would have brought its stake in the target firm to 27.5%.¹⁵⁶ CTS also adopted a "poison pill" defense.¹⁵⁷ In *Fleet Aerospace*, the tender offer was for all outstanding shares of the target firm, Aeronca.¹⁵⁸ The facts are similar, yet apparently seemed unimportant to the courts. The *Fleet Aerospace* statement of facts takes less than a typewritten page, and the only details discussed in *Dynamics* relate to the poison pill. What mattered to the courts, it seems, was that the bidders had sued to enjoin enforcement of the Indiana and Ohio control share acquisition laws, claiming that these laws violated the Supremacy and Commerce Clauses—which meant, of course, that the laws had to be struck down.

On the Supremacy Clause issue, both courts were quick to conclude that the Williams Act preempted the state statute. Judge Posner opined:

The Indiana statute upsets the balance struck by the Williams Act. Whether it does so more than the Illinois statute struck down in *MITE* is hard to say. The statutes are incommensurable. The Illinois statute both imposed delay and put the acquirer at the mercy of the Illinois Secretary of State; the Indiana statute imposes slightly greater delay but puts the acquirer at the tenderer's mercies of the "disinterested" shareholders. If we had to guess we would guess that the Indiana statute is less inimical to the tender offer, but that is unimportant. The Indiana statute may have been a lethal dose; the fact that the Illinois statute may have been two or three lethal doses has no practical significance.¹⁵⁹

Posner, one of the founders and most effective partisans of law and economics. It is, however, simply unfortunate that the Sixth Circuit, in *Fleet Aerospace*, chose merely to summarize the holding of the trial court—not its analysis—and conclude, "[we] agree substantially for the reasons expressed by Judge Holschuh" on the Supremacy Clause issue and "the Ohio law . . . offends the Commerce Clause for essentially the reasons stated by the district court." *Fleet Aerospace Corp. v. Holderman*, 796 F.2d 135, 139 (6th Cir. 1986). One may take heart, however, at the Sixth Circuit's caveat:

We have reservations, however, about the district court's conclusionary statement that *MITE Corp.* "sounded the death knell for state control of federally regulated tender offers," if the court meant by this statement that all state regulation regarding tender offers is foreclosed. See the concurring opinions of Justice Powell and Justice Stevens. . . .

Id. at n.5 (emphasis in original) (citations omitted).

Icahn v. Blunt, 612 F. Supp. 1400 (W.D. Mo. 1985) and *APL Limited Partnership v. Van Dusen Air, Inc.*, 622 F. Supp. 1216 (D. Minn. 1985), *vacated* Case Nos. 85-5285 & 85-5286 (8th Cir. Nov. 26, 1985), both dealt with statutes similar to those of Ohio and Indiana. *Icahn* involved one of the most flagrant cases of economic protectionism ever to find its way into the law reports. See 612 F. Supp. 1400, 1402-06 for an account of how speedily the State of Missouri amended its Control Acquisition Statute to cover foreign corporations in order to protect Trans World Airlines, a Delaware corporation, from *Icahn's* anticipated takeover bid. The bill was drafted to cover "foreign corporations that are common carriers that have benefitted from physical facilities financed by Missouri political subdivisions." The state senate took up the amendment on May 19, 1985, and passed it on May 30; suit to enjoin its enforcement was filed later that same day. Whether the legislators or the lawyers would reach the courthouse first seems to have been an open question.

Van Dusen Air reached erroneous conclusions, but represents an attempt at real analysis of the issues raised by control share acquisition statutes. Its status is uncertain after being vacated.

154. 794 F.2d 250 (7th Cir. 1986), *cert. granted*, 107 S. Ct. 258 (1986).

155. 637 F. Supp. 742 (S.D. Ohio), *aff'd*, 796 F.2d 135 (6th Cir. 1986).

156. *Dynamics Corp. v. CTS Corp.*, 794 F.2d 250, 257-58 (7th Cir. 1986), *cert. granted*, 107 S. Ct. 258 (1986).

157. *Id.* at 254-55.

158. *Fleet Aerospace Corp. v. Holderman*, 796 F.2d 135, 136 (6th Cir. 1986).

159. *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250, 262-63 (7th Cir. 1986), *cert. granted*, 107 S. Ct. 258 (1986).

From this analysis Posner reached his conclusion:

Very few tender offers could run the gauntlet that Indiana has set up. In any event, if the Williams Act is to be taken as a Congressional determination that a month (roughly) is enough time to force a tender offer to be kept open, 50 days is too much; and 50 days is the minimum under the Indiana act if the target corporation so chooses.¹⁶⁰

The federal district court, whose opinion the Sixth Circuit relied on in *Fleet Aerospace*, also ruled that a fifty-day waiting period (this time required by the Ohio statute) was too long to comport with the Williams Act.¹⁶¹ The requirement of a shareholder vote, the district court concluded, was contrary to the Williams Act's policy of regulatory neutrality because it increased the likelihood of a proxy contest. This might delay the offer's completion, would probably increase its expense, and might generally discourage all tender offers.¹⁶² Furthermore, the requirement of a shareholder vote "prevents the individual investor from deciding whether to sell his or her stock to the offeror [by placing] the decision in the hands of other shareholders."¹⁶³

These rationales, complete in themselves, are significantly flawed. First, it is misleading to claim, as Posner does, that a court acts with the authority of "the Supreme Court plurality in *MITE*"¹⁶⁴ when it finds state takeover statutes preempted. Only three justices in that case found the Supremacy Clause an appropriate tool to use against state takeover regulation; just as many justices found the case moot. Second, the time periods which look so different harmonize far more readily than these opinions suggest. The Williams Act implies that tender offers might not be concluded within sixty days by giving shareholders the right to withdraw their tendered shares sixty days after an offer begins.¹⁶⁵ Third, it is indeed probable that a shareholder vote will hinder the completion of a tender offer—but this consideration would be better factored into a Commerce Clause analysis.

Finally, it is true that control share acquisition statutes place the merits of a tender offer before all the shareholders of a corporation, but this is the very point of shareholder democracy. To say that this harms the individual shareholder is to say that the individual shareholder should be free to be stampeded. Any decision can be valid only when it is free and uncoerced. As has been shown, tender offers leave the individual shareholder in a classic prisoner's dilemma, with no choice but to tender his or her shares.¹⁶⁶ Informed choice is the spirit of the Williams Act, and a state

160. *Id.* at 263. For the time-frame imposed by the Williams Act and the SEC rules promulgated under it, see 17 C.F.R. § 240.14-1(a) (1986), which requires that a tender offer be kept open for 20 business days.

161. See *Fleet Aerospace Corp. v. Holderman*, 637 F. Supp. 742, 756 (S.D. Ohio), *aff'd*, 796 F.2d 135 (6th Cir. 1986).

162. *Id.* at 21-22.

163. *Id.* at 18. This point was first raised in *Icahn v. Blunt*, 612 F. Supp. 1400, 1420 (W.D. Mo. 1985).

164. *Dynamics Corp. v. CTS Corp.* 794 F.2d 250, 262 (7th Cir. 1986), *cert. granted*, 107 S. Ct. 258 (1986).

165. See § 14(d)(5) of the 1934 Act, 15 U.S.C. § 78n(d)(5) (1982), which allows the withdrawal of tendered securities "at any time after sixty days from the date of the original tender offer except as the Commission may otherwise prescribe"; Rule 14d-7(a)(1), 17 C.F.R. § 240.14d-7 (1986), which gives tendering shareholders the right to withdraw their shares up to fifteen days into a tender offer.

166. See Lowenstein, *supra* note 107.

statute which works in conjunction with the Act only furthers this policy. Individual shareholders can optimize their benefits only if they know what the other shareholders are doing. This is the purpose of the shareholder vote: to minimize take-it-or-leave-it bargaining, and bring some sunlight into the cell.

The opinion in *Dynamics* can be faulted for failing to identify which Commerce Clause standard it applied. The terms used were those of the *Pike v. Bruce Church, Inc.*¹⁶⁷ balancing test, which received a majority in *MITE*. Yet in his conclusion, Judge Posner apparently voided the law as a direct regulation of interstate commerce: "The law in question is an explicit regulation of tender offers; that the mode of regulation involves jiggering with voting rights cannot take it outside the scope of judicial reviews under the commerce clause. Any other conclusion would invite facile evasions of the clause."¹⁶⁸

Other factors in the Seventh Circuit's discussion seem clearly used as factors in a balancing of interests test. "The statute gravely impairs *Dynamics*' ability to do business with any of CTS's shareholders," Posner wrote. "Indiana has no interest in protecting residents of Connecticut . . . [T]he Indiana statute is calculated to impede transactions between residents of other states. For the sake of trivial or even negative benefits to its residents Indiana is depriving nonresidents of the valued opportunity to accept tender offers from other nonresidents."¹⁶⁹ Arguments based on takeover theory resurfaced at the end of the discussion:

The commerce clause does not allow states to prevent corporations from moving assets and employees to other states. But whether or not an anti-takeover statute is vulnerable to challenge under the commerce clause if it impedes mobility of corporate assets, it is highly vulnerable if it impedes the important commerce in corporate control. Even if a corporation's tangible assets are immovable, the efficiency with which they are employed and the proportions in which the earnings they generate are divided between management and shareholders depends upon the market for corporate control—an interstate, indeed international, market that the State of Indiana is not authorized to opt out of, as in effect it has done in this statute.¹⁷⁰

The *Fleet Aerospace* district court likewise found the Ohio Control Share Acquisition Act to be an impermissible attempt at direct regulation of interstate commerce. It buttressed its ruling with a recital of the Seventh Circuit's conclusion.¹⁷¹ (Most of its discussion of the state's authority to regulate corporate control treated this as an indirect burden).¹⁷² More important to the district court was the statute's "extraterritorial reach." The court reasoned:

[A]n individual residing in New York who owned a twenty percent interest in an Ohio corporation could not sell that interest to a California resident without being subject to the OCSAA. That single sale would require a shareholder meeting and shareholder approval

167. *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250, 263 (7th Cir. 1986), *cert. granted*, 107 S. Ct 258 (1986).

168. *Id.* at 264.

169. *Id.* at 263-64.

170. *Id.* at 264.

171. *Fleet Aerospace Corp. v. Holderman*, 637 F. Supp. 742, 762 (S.D. Ohio), *aff'd*, 796 F.2d 135 (6th Cir. 1986).

172. See *infra* text accompanying note 182.

before it could proceed. This emphasizes the direct, extraterritorial restraint on interstate commerce imposed by the OCSAA.¹⁷³

The court's discussion of the statute's indirect effect on commerce was more detailed and considered than that of the Seventh Circuit. It began by equating the required shareholder vote with what *MITE* condemned—direct intervention by local officials—and held (citing the *MITE* passage which cited Easterbrook and Fischel) that this posed a substantial obstacle to the national market in securities.¹⁷⁴ From there it advanced to the two interests asserted by Ohio: The state's authority to regulate corporate internal affairs, and the state's power to regulate resident shareholders as shareholders in an Ohio corporation.¹⁷⁵

The latter argument was handled summarily. The court cited *MITE* to the effect that "while protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders."¹⁷⁶ A focus on residence rather than capacity was thus maintained—a regrettable omission, because the state's other argument was closely related.

In rejecting the internal affairs argument, the court again relied upon *MITE* for its holding that "a tender offer does *not* come within the ambit of the 'internal affairs' of a corporation."¹⁷⁷ More interesting, however, was the reliance the court placed upon the analysis of *APL Ltd. Partnership v. Van Dusen Air*.¹⁷⁸

Van Dusen Air, which involved virtually identical arguments, had attempted to draw a principled distinction between a state's regulation of control transactions and regulation of shareholders who had received a tender offer. The Minnesota district court there said:

The state's merger analogy perpetuates the state's confusion between regulation of a corporation and the regulation of those who would trade in shares. One obvious difference between the [Minnesota Control Share Acquisition Statute] and those provisions of the [Minnesota Business Corporation Act] requiring shareholder approval for a merger or sale of assets is that the latter only apply to Minnesota corporations. The merger provision of the MBCA restricts the ability of a *Minnesota corporation* to merge. That is a lawful exercise of the state's authority to regulate a legal entity created by state statute. While the MCSAA also applies only to Minnesota corporations, it does not purport to regulate the activities of the corporation; rather, it reaches out and regulates shareholders who may or may not be residents of Minnesota.¹⁷⁹

The *Van Dusen* court tentatively sketched in a borderline: "The acquisition of shares does not implicate the internal affairs of the target corporation. The use of that power

173. *Fleet Aerospace Corp. v. Holderman*, 637 F. Supp. 742, 759–60 (S.D. Ohio), *aff'd*, 796 F.2d 135 (6th Cir. 1986).

174. *Id.* at 760.

175. *Id.* at 761. A third interest was asserted by defendant Aeronca: "That the statute helps protect the business climate of the state by protecting Ohio corporations from wholesale raids by foreign companies." *Id.* Ultimately the court dismissed fears of raiding as based upon speculation, as an impermissibly protectionist motive for legislation, and as discriminatory, in that the Ohio Control Share Acquisition Act did not prevent Aeronca's incumbent management from moving its Ohio plant outside the state. *Id.* at 763.

176. *Id.* at 762–63.

177. *Id.* at 761 (emphasis in original).

178. 622 F. Supp. 1216 (D. Minn. 1985).

179. *Id.* at 1224 (emphasis in original).

once the shares have been acquired may well be a proper subject of state regulation."¹⁸⁰

Following this argument, and again citing *Dynamics*, the *Fleet Aerospace* court concluded:

In short, tender offers themselves do not create changes in the internal affairs of the corporation in the sense that mergers and consolidations effect such changes. If the tender offer is successful, it is true that voting control may well be changed, but the changing identity of the shareholder or shareholders owning sufficient stock to exercise control does not of itself change the nature of the corporation or alter its internal affairs.¹⁸¹

The Ohio Control Share Acquisition Act was thus held unconstitutional as an indirect burden on interstate commerce.¹⁸²

At the heart of *Dynamics* and *Fleet Aerospace* is a failure to consider why shares exist and how the voting rights they carry actually relate to corporate control. The rulings that control share acquisition laws can have no extraterritorial application and that such laws cannot be defended on the authority of the state to regulate a corporation's internal workings stem from a failure to understand the basic nature of the corporation. Shareholders' rights exist because the state creates them.

Assume, for example, that a person holds stock in a corporation chartered in Ohio, even though he or she resides in New York. (And, possibly, might wish to tender shares to a bidder who lives in California). The only reason this person has the share to sell is that Ohio chartered the corporation and guaranteed that the rights embodied in that share will be enforced. The rights exist because Ohio permitted use of the corporate form, allowed the organizers of the corporation to create a separate legal entity, and allowed investors to speculate, without fear of personal liability, in a financial interest which could be readily liquidated.

It is capacity, not residency, that counts. No matter where the holders of an Ohio corporation's shares live, it is as Ohio shareholders, franchisees of the state, that they

180. *Id.* at 1223-24 (emphasis in original).

181. *Fleet Aerospace Corp. v. Holderman*, 637 F. Supp. 742, 762 (S.D. Ohio), *aff'd*, 796 F.2d 135 (6th Cir. 1986).

182. *Id.* As a result of *Fleet Aerospace*, Ohio's corporation code was revised. The additions which were made last November represent an alternative to control share acquisition laws. These new laws expand significantly the business judgment rule, and explicitly cover battles for corporate control. 1986 Ohio Legis. Serv. 5-693 (Baldwin). Corporate directors, in deciding whether to resist a takeover, may now take into account the "long-term as well as the short-term interests" of the firm and its shareholders—as well as those of creditors, the work force, and other groups. *Id.* Corporate directors are insulated from monetary liability unless clear and convincing evidence proves their deliberate intent to injure their firm or a reckless disregard for their corporation's welfare. *Id.* Also included, subject to a sunset provision with a 1987 expiration date, is a section expressly validating shareholder rights plans—"poison pills." *Id.* at 5-691.

Such provisions, upon careful analysis, are not as radical a departure as they may at first appear. Their grant of power is liberal, but they do little more than codify powers which corporate directors possessed *de facto* under the existing business judgment rule. The new Ohio laws seem radical because they envision directors contesting tender offers, and because they recognize explicitly that a corporation should not be reduced to an abstraction of shareholders, target management, and corporate bidders.

It would be unfortunate, however, if such laws became the only way in which states can express their policy on takeovers. Shareholders' welfare seems too important a concern to be decided by a battle between corporate raiders and target managers; these groups' self-interests may not always be enlightened. It would be better to let shareholders protect their own interests through the voting rights assured by control share acquisition statutes. The state's interest in regulating corporations, similarly, would be better served by direct statutory controls than by trusting high-pressure litigation to produce socially desirable results.

acquired the rights which are solicited in tender offers.¹⁸³ Transactions in corporate control, similarly, while they occur in a national or even international setting, in a very real sense occur within the corporation. Shareholders may have different domiciles, but it is as shareholders *qua* shareholders that they ultimately meet.

It is not really a question of rights being limited by the chartering state's law. Rather, it is a question of rights being defined, because every definition is in some sense a limitation. If a resident of Delaware finds his rights as a shareholder of an Indiana corporation affected by Indiana law, it is because Indiana law defined those rights when it created them. This can hardly be protectionism; if it is, then any privilege granted by a state will have its limitations dissolved as soon as it enters the stream of interstate commerce.

The *Van Dusen Air* district court made a rare attempt to deal with the apparent quandary of a state being able to regulate mergers but prohibited from regulating tender offers. Unfortunately, it wound up distinguishing tender offers from control transactions, rather than control share acquisition statutes from first-generation takeover laws. Its judgment is solomonic, but does not withstand analysis. Shareholders have rights because the state creates them (which the court correctly noted); it is to protect those rights from abuse that the chartering state imposes restrictions on mergers, sales of assets, and dissolutions. All these transactions pose risks which can best be dealt with by shareholder voting. Exactly the same risks are presented by tender offers. To ensure that these rights continue to be protected, states must have power to impose similar safeguards.

Moreover, if the Commerce Clause prevents states from policing the market for corporate control, it should hardly matter at which stage they regulate. If they cannot regulate at the tender offer stage, why should they be able to regulate the use made of the voting power thus acquired? The power to regulate tender offers and the power to regulate traditional control transactions either fall or stand together.

Judge Posner should have noted this. One of the sources he cited in *Dynamics*, a 1983 article by Professor Saul Levmore, was the only article contemporaneous with *MITE* to note how sharp a sword the case had furnished to corporate raiders. (Levmore had noticed "a rather startling potential for commerce clause claims in corporate law after *MITE*," there being "no clear line between internal affairs and the commerce clause concerns underlying *MITE*.".)¹⁸⁴ This is not the only place where

183. Freedom of contract cuts both ways. If investors know that a corporation is chartered in a state which has a control share acquisition statute—or in any other way acts to inhibit tender offers—their purchase of shares must be taken as an acceptance of those terms. "When, by acquisition of his stock, plaintiff became a member of the corporation, he, like every other shareholder, impliedly agreed that in respect of its internal affairs the company was to be governed by the laws of the State in which it was organized." *Rogers v. Guaranty Trust Co.* 288 U.S. 123, 130 (1933).

184. Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VA. L. REV. 563, 624 (1983) (quoted in *Dynamics Corp. of America v. CTS*, 794 F.2d 250, 263 (7th Cir.), cert. granted, 107 S. Ct. 258 (1986)). The very section cited by Posner opens:

[There is] a rather startling potential for commerce clause claims in corporate law after *MITE*. The court insisted that its decision did not affect the state interest in regulating internal corporate affairs because "[t]enders contemplate transfers of stock to a third party and do not themselves implicate the internal affairs of the target company." But . . . there is no clear line between "internal affairs" and the commerce clause concerns underlying *MITE*.

. . . Whole portions of the opinions in *MITE* are directly transferable to cases regarding sale of control.

analysis was lacking. *Dynamics* and *Fleet Aerospace* should not have assumed that declaiming the conclusions of law-and-economists is enough to establish a national interest in favoring corporate takeovers. This is not to say that takeover theory is indefensible—but it has come under such heavy, sustained, and accurate criticism that a defense of it is now necessary.¹⁸⁵

In *MITE*, the Supreme Court suggested that a state's corporation law, even if it affected tender offers in the national securities markets, would be upheld if it were limited to domestic corporations, did not pose an absolute and insurmountable obstacle to takeovers, and did not designedly favor target management or disfavor out-of-state bidders.¹⁸⁶ Both the Ohio and Indiana Control Share Acquisition statutes meet these criteria.

The statutes apply only to firms that are Ohio and Indiana corporations in both the legal and popular senses—companies chartered by and economically linked to the governing state. By referring tender offers to a shareholder vote, the statutes reduce management's incentive to adopt scorched-earth, crown jewel, or poison pill defenses, and minimize the opportunities for protectionism. Unlike the target firm's executives (whose main concern may be keeping their jobs) or state officials (who may defend local interests too zealously), shareholders presumably vote their pocketbooks. Any offer favorable enough to make them want to tender their shares should find no trouble winning authorization. The shareholder vote, additionally, is probably as even-handed a device as possible for weighing the competing claims of corporate raiders and target management.

VI. CONCLUSION

The litigation which has followed *MITE* can only be described as an aftermath. In the last four years, nearly a score of state laws affecting takeovers have been struck

Similarly, other "internal affairs" of the corporation may involve the commerce clause concerns expressed in *MITE*. Examples include any rules that affect the potential for speedy interstate acquisitions: shareholder voting rights, supermajority voting requirements, proxy regulation, restrictions on share transferability, compensation schemes that tend to "lock in" management, regulations affecting corporate combinations, and, most interestingly, state remedies with respect to insider trading that exceed those provided under federal law.

Id. at 624–25 (citations omitted).

185. It is an oversimplification to treat corporate control as a Manichean struggle between shareholders and management. A corporation involves many interests, each of which exists in the context of all the others. It is tempting to argue that the corporation has evolved beyond the law to become a creation of contract. To focus on finance is deceptive, however; it minimizes too many other valid concerns. William Agee, the former chairman of Bendix Corporation, led his firm into a takeover battle with Martin Marietta in August, 1982. Marietta countertendered for control of Bendix, and Agee sold the firm out from under himself. From a financial viewpoint, the transaction was highly successful: tendering Bendix shareholders received \$75 to \$80 for shares which had been trading at around \$55. Bendix itself was absorbed into Allied Corporation, however, and what had been the 86th largest company in America vanished. See A. SLOAN, *THREE PLUS ONE EQUALS BILLIONS: THE BENDIX-MARTIN MARIETTA WAR* 22, 175, 246–47 (1983).

186. If corporations are seen only as abstract financial institutions, divorced from any considerations except profit and payout, it seems self-interested, and therefore constitutionally impermissible, for a state to enact laws which favor local control of its economic life. When one realizes, however, that the decision to allow incorporation involves the state's sovereign power to promote the general welfare of its people, and is thus inextricably bound up with economic considerations, the matter becomes less clear. It was this recognition that was made in Justice Powell's concurrence, and the matter cannot be dismissed with the retort that any hint of protectionism is still too much. Local interests cannot control, but they should not be ignored. The Commerce Clause, while it forbids the economic balkanization of the United States, does not justify or enshrine the concentration of economic power.

down, in whole or in part, while a handful of cases have upheld state statutes. Some decisions, on either side, seem questionable. Standards and analysis have deteriorated. Whether a court uses the Supremacy Clause, the Commerce Clause, or both, barely seems to matter—the same factors can be fed into either analysis to generate the same result. With state legislatures tirelessly passing new takeover laws as fast as the old ones fall, the war of attrition seems interminable.

Most of the difficulty owes directly to the ambiguities in the *MITE* decision. The case has been too easy to misread.¹⁸⁷ To judge from its progeny, one could conclude that the opinion gave courts *carte blanche* to strike down any state takeover law, using the first rationale at hand, and intimated that the Commerce Clause had been written to constitutionalize law and economics as taught at the University of Chicago. The Supreme Court clearly did not approve either of these conclusions; it should now make this clear. Also unsettled is the question of how *MITE* relates to *Cort v. Ash*, *Santa Fe*, and the other cases affirming the states' role in corporate law—cases in which the Court's intention was unmistakably clear.¹⁸⁸

Dynamics and *Fleet Aerospace* offer the Court an opportunity to make these clarifications. In doing so, the Court will be presented with one of federalism's oldest issues: Whether corporate regulation belongs to the states or to the federal government. It will also face the implications of the corporation's identity as a creation of the state.

Matters concerning the division of powers come to the fore. The consensus on this issue is surprisingly broad. It was Professor Laurence Tribe who wrote: "[T]he negative implications of the Commerce Clause derive centrally from a political theory of union, not primarily from an economic theory of free trade. The function of the clause is to insure national solidarity, not national efficiency."¹⁸⁹ It is the Reagan Administration which has opposed changes to the Williams Act on the grounds that such legislation "would intrude unnecessarily into state law and constitute an unwarranted step toward imposition of a substantive federal corporation law."¹⁹⁰ Equally significant, there is no consensus on any alternative. The Tender Offer Reform Act of 1984, H.R. 5693, was withdrawn in 1985, and other federal legislation is currently dead in the water.

Federalizing corporation law involves the risks of concentrating economic power; that is one reason not to do so. The definition of society's basic economic units—trusts, partnerships, corporations, and other property tenures and enterprise

187. Part of the trouble, to be sure, comes from the very nature of takeover litigation. With time at a premium, few decisions of any sort—legal, financial, or judicial—are as considered as they otherwise might be. While cases are winding their way through the courts, bids are abandoned or compromises reached. The result is that decisions remain where the last court left them, instead of being touched up or reversed.

188. One court of appeals has noticed the outlines of the problem. The First Circuit, in *Agency Rent-A-Car Inc., v. Connolly*, 686 F.2d 1029 (1st Cir. 1982), noted that while *MITE* casts doubt on the validity of state regulation affecting tender offers, it did not mandate its preemption, and concluded that the proper course of action was to abstain from ruling on the constitutionality of the Massachusetts takeover statute.

189. L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 25 (Supp. 1979).

190. *Reagan Administration Opposes House Tender Offer Bill*, [Sept. 28, 1984] SEC. REG. & L. REP. (BNA) Vol. 16, No. 38, 1546 (Treasury Secretary Donald Regan's letter of Sept. 25, 1986 to John Dingell, Chmn. of House Energy & Commerce Committee).

vehicles—is not a matter of federal concern. The states have been effective at creating and governing corporations. That is another, positive reason to leave this role with them. The Constitutional Convention chose not to federalize corporation law; the Progressives and New Dealers chose not to federalize corporation law; and we in the 1980s can profit from their example. Particularly in the Constitution's bicentennial year, we should note that the balance struck by the Philadelphia Convention has not only been upheld, but has been reaffirmed.